Supreme Court, U. S.
FILED
SEP 15 1977
MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

October Term, 1977

No. 77-410

CITY OF PHILADELPHIA and LENNOX L. MOAK, as Director of Finance, Individually and as Representatives of the Class,

Appellants,

v.

SECURITIES AND EXCHANGE COMMISSION, RODERICK M. HILLS, Chairman, PHILIP A. LOOMIS, JR., Commissioner, JOHN R. EVANS, Commissioner, IRVING M. POLLACK, Commissioner, PAUL F. LEONARD, Administrator of Region 9, THOMAS H. MONAHAN, Assistant Regional Administrator.

Appellees.

On Appeal From the United States District Court for the Eastern District of Pennsylvania.

JURISDICTIONAL STATEMENT

SHELDON L. ALBERT,
City Solicitor,
City of Philadelphia,
15th Fl., Municipal Services Bldg.,
Philadelphia, Pa. 19107
Counsel for Appellants.

EDWIN P. ROME,
WILLIAM E. TAYLOR, III,
JEANNE P. WROBLESKI,
BLANK, ROME, KLAUS & COMISKY,
1100 Four Penn Center Plaza,
Philadelphia, Pa. 19103
Special Counsel for Appellants.

ROBERT W. SAYRE,
JOSEPH B. STURGIS,
JOHN C. S. KEPNER,
THOMAS J. SHARBAUGH,
SAUL, EWING, REMICK & SAUL,
38th Fl., Centre Square West,
Philadelphia, Pa. 19102
Special Counsel for Appellants.

International Printing Co., 711 So. 50th St., Phila., Pa. 19143 — Tel. (215) 727-8711

TABLE OF CONTENTS.

	Page
OPINION BELOW	2
JURISDICTION	2
CONSTITUTIONAL PROVISIONS, STATUTES AND RULES INVOLVED	4
QUESTIONS PRESENTED	5
STATEMENT OF THE CASE	6
THE FEDERAL QUESTION PRESENTED IS SUBSTANTIAL	9
I. The Court Below Erred in Determining the Constitutionality of the Preliminary Investigation Without Considering the Constitutionality of the Substantive Provisions of the Securities Acts	9
II. This Appeal Presents a Fundamental Constitutional Question Which Should Be Heard and Determined by the Supreme Court of the United States	12
A. This Appeal Presents a Question Central to the Proper Constitutional Relationship Between the States and the Federal Government	13
B. This Appeal Presents a Question of Vital Importance to the Independent Existence of State and Local Governments	16
C. The Decision Below Is Inconsistent With This Court's Decision in National League of Cities	20
CONCLUSION	24
APPENDIX:	
A. Three-Judge District Court's Opinion Below, City of Philadelphia and Lennox L. Moak, et al. v. Securities and Exchange Commission, et al., C. A. 76-2396 (E. D. Pa. May, 1977)	A1
B. Three-Judge District Court's Order, City of Philadelphia and Lennox L. Moak, et al. v. Securities and Exchange Commission, et al., C. A. 76-2396 (E. D. Pa. May 20, 1977)	A15
C. Constitutional Provisions, Statutes and Rules	A17
D. Notice of Appeal	A31

TABLE OF AUTHORITIES.

Cases:	Page
A. L. A. Schechter Poultry Corp. v. United States, 295 U. S. 495 (1935)	11
Allied Stores of Ohio, Inc. v. Bowers, 358 U. S. 522 (1959)	16
Ashton v. Cameron County Water Improvement Dist., 298 U. S. 513 (1936)	14, 17
Drew v. United States, 394 F. Supp. 340 (S. D. Texas 1975)	17
Edelman v. Jordan, 415 U. S. 651 (1974)	17
Ernst & Ernst v. Hochfelder, 425 U. S. 185 (1976)	11
Huffman v. Pursue, Ltd., 420 U. S. 592 (1975)	15
Johnson v. Maryland, 254 U. S. 51 (1920)	13
Lane County v. Oregon, 74 U. S. 101 (1869)	13
Larche v. Hannah, 177 F. Supp. 816 (W. D. La. 1959), reversed, 363 U. S. 420 (1960)	11
Lynch v. Household Finance Corp., 405 U. S. 538 (1972)	4
MTM, Inc. v. Baxley, 420 U. S. 799 (1975)	3
Matthews v. Eldridge, 424 U. S. 319 (1976)	11
National League of Cities v. Usery, 426 U. S. 833 (1976)	8, 11, 12, 15, 16, 19, 20, 22, 23
New York v. United States, 326 U. S. 572 (1946)	18
O'Shea v. Littleton, 414 U. S. 488 (1974)	15
Panama Refining Co. v. Ryan, 293 U. S. 388 (1935)	11
Pollock v. Farmers' Loan & Trust Co., 157 U. S. 429 (1895)	17
Rizzo v. Goode, 423 U. S. 362 (1976)	15
Tully v. Griffin, Inc., 429 U. S. 68 (1976)	17
United States v. Darby, 312 U. S. 100 (1941)	22
Younger v. Harris, 401 U. S. 37 (1971)	14

United States Constitution:

Amendment V	2, 8, 24
Amendment X	2, 4, 5, 8, 9, 23

TABLE OF AUTHORITIES (Continued).

Statutes:	Page
28 U. S. C. § 1253	3, 4
28 U. S. C. § 1331	2
28 U. S. C. § 1337	2
28 U. S. C. § 2201	2
28 U. S. C. § 2282	3
28 U. S. C. § 2284	3
Section 2(2) of the Securities Act of 1933, 15 U. S. C. § 77b(2)	4, 6
Section 3(a)(2) of the Securities Act of 1933, 15 U. S. C. § 77c(a)(2)	4, 7, 18
Section 12(2) of the Securities Act of 1933, 15 U. S. C. § 771(2)	4, 23
Section 17 of the Securities Act of 1933, 15 U. S. C. § 77q	4, 23
Section 19(b) of the Securities Act of 1933, 15 U. S. C. § 77s(b)	4, 6, 10, 23
Sections 20(a) and (b) of the Securities Act of 1933, 15 U. S. C. §§ 77t(a) and (b)	4, 6, 23
Section 24 of the Securities Act of 1933, as amended, 15 U. S. C. § 77x	4, 23
Section 3(a)(9) of the Securities Exchange Act of 1934, as amended, 15 U. S. C. § 78c(a)(9)	4, 6
Section 3(a)(12) of the Securities Exchange Act of 1934, as amended, 15 U. S. C. § 78c(a)(12)	4, 7, 19
Section 3(d) of the Securities Exchange Act of 1934, 15 U. S. C. § 78c(d)	5, 7, 19
Section 10(b) of the Securities Exchange Act of 1934, 15 U. S. C. § 78j(b)	5, 23
Section 15B(d)(1) of the Securities Exchange Act of 1934, 15 U. S. C. § 78o-4(d)(1)	5, 7, 19
Sections 21(a) and (e) of the Securities Exchange Act of 1934, as amended, 15 U. S. C. §§ 78u(a) and (e)	5, 6, 10, 23
Section 32(a) of the Securities Exchange Act of 1934, 15 U. S. C. § 78ff(a)	5, 23

TABLE OF AUTHORITIES (Continued).

	Page
Regulations:	
Rule 202.5, 17 C. F. R. § 202.5, Securities and Exchange Commission	5, 6, 10
Rule 203.4, 17 C. F. R. § 203.4, Securities and Exchange Commission	5, 6
Rule 10b-5, 17 C. F. R. § 240.10b-5, Securities and Exchange Commission	23
Other Authorities:	
I Loss, Securities Regulations (1961)	18

IN THE

Supreme Court of the United States

—

OCTOBER TERM, 1977

—

No.

—

CITY OF PHILADELPHIA and LENNOX L. MOAK, as Director of Finance, Individually and as Representatives of the Class,

Appellants,

v.

SECURITIES AND EXCHANGE COMMISSION, RODERICK M. HILLS, Chairman, PHILIP A. LOOMIS, JR., Commissioner, JOHN R. EVANS, Commissioner, IRVING M. POLLACK, Commissioner, PAUL F. LEONARD, Administrator of Region 9, THOMAS H. MONAHAN, Assistant Regional Administrator,

Appellees.

—

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA

—

JURISDICTIONAL STATEMENT

Appellants, the City of Philadelphia and Lennox L. Moak, for themselves and the class they represent, appeal from the May 20, 1977 Order of a Three-Judge Court of the United States District Court for the Eastern District of Pennsylvania, dismissing Appellants' Amended Complaint and denying their requests for injunctive and declaratory relief. Appellants submit this Statement to establish that the Supreme Court of the United States has jurisdiction of this appeal and that the appeal presents a substantial constitutional question.

OPINION BELOW

The Opinion and Order of the United States District Court for the Eastern District of Pennsylvania, Civil Action No. 76-2396 (E. D. Pa. May 20, 1977), are as yet unreported. The Opinion and Order are printed respectively as Appendix A and Appendix B hereto, *infra*, pp. A1 to A16.

JURISDICTION

Appellants instituted this action, as a class action, in the United States District Court for the Eastern District of Pennsylvania on July 29, 1976, pursuant to 28 U. S. C. §§ 1331 and 1337, in response to an ongoing preliminary investigation by the Securities and Exchange Commission (the "Commission") into possible violations of the federal Securities Acts by the City of Philadelphia (the "City"). In their Amended Complaint filed August 17, 1976, Appellants sought a declaration under 28 U. S. C. § 2201 that the Securities Act of 1933, as amended, 15 U. S. C. §§ 77a *et seq.* (the "1933 Act"), the Securities Exchange Act of 1934, as amended, 15 U. S. C. §§ 78a *et seq.* (the "1934 Act"), and certain of the rules and regulations promulgated under each Act, violated Appellants' rights under the Fifth and Tenth Amendments to the Constitution of the United States to the extent they purported to subject Appellants to the Commission's jurisdiction and to the investigatory, injunctive, anti-fraud and criminal provisions of the federal Securities Acts, and were unconstitutional and unenforceable. In addition to the declaratory judgment, Appellants specifically requested that the Court enjoin the Commission preliminarily, pending a final determination of the action, and permanently thereafter from requesting or subpoenaing documents or testimony

from Appellants, from conducting any investigation of Appellants' affairs and from otherwise applying the Acts to Appellants. Pursuant to 28 U. S. C. § 2282 (since repealed) and § 2284 (since amended), a Three-Judge Court was convened to hear and determine the action.

On May 20, 1977, the Court entered an Order dismissing the Amended Complaint and issued an Opinion in which it concluded that the Commission's preliminary investigation was constitutional and that Appellants' challenges to the substantive provisions of the Acts were not ripe for adjudication. The Opinion and Order had the effect of denying all of Appellants' requests for injunctive relief. No petition for rehearing was filed. A Notice of Appeal to this Court was filed with the District Court on July 18, 1977.[1] The Notice of Appeal to this Court is printed as Appendix D hereto, *infra*, p. A31.

Under 28 U. S. C. § 1253, this Court has jurisdiction to hear a direct appeal from a decision of a properly convened Three-Judge Court that grants or denies an interlocutory or permanent injunction in a civil action. In *MTM, Inc. v. Baxley*, 420 U. S. 799, 804 (1975), this Court held that a direct appeal to the Supreme Court under § 1253 from an order of a Three-Judge Court will lie if the order denied interlocutory or permanent injunctive relief and rested "upon resolution of the merits of the constitutional claim presented below." The Order entered below (App. B, *infra*, p. A15) satisfies both these requirements.

First, the Order dismissing Appellants' constitutional challenge to the preliminary investigation and the related substantive provisions of the 1933 and 1934 Acts had the effect of denying injunctive relief. Although Appellants never formally moved for a permanent injunction, the

1. On the same date, a concurrent appeal was taken to the United States Court of Appeals for the Third Circuit. On July 29, 1977, the Court of Appeals entered an Order staying that appeal during the pendency of the appeal to this Court.

prayers for relief in the Amended Complaint requested that the Commission be enjoined from conducting any type of investigation of the City and from otherwise subjecting Appellants to the provisions of the 1933 and 1934 Acts allegedly applicable to them. In *Lynch v. Household Finance Corp.*, 405 U. S. 538, 541 n. 5 (1972), this Court stated that the dismissal of a complaint in which injunctive relief was sought satisfied the requirements of § 1253, even though the request for injunctive relief was never considered separately. Second, the Order dismissing Appellants' action was based on a resolution of the merits of the constitutional issues presented. The Three-Judge Court directed the parties to submit briefs on the constitutional issues and in its Opinion specifically held that the Commission's preliminary investigation was constitutional. This holding supplied the Court's only basis for dismissing what it characterized as Appellants' challenge to the preliminary investigation.

CONSTITUTIONAL PROVISIONS, STATUTES AND RULES INVOLVED

This case involves:

(A) The Tenth Amendment to the Constitution of the United States;

(B) Section 2(2), 15 U. S. C. § 77b(2); Section 3(a)(2), 15 U. S. C. § 77c(a)(2); Section 12(2), 15 U. S. C. § 771(2); Section 17, 15 U. S. C. § 77q; Section 19(b), 15 U. S. C. § 77s(b); Sections 20(a) and (b), 15 U. S. C. §§ 77t(a) and (b); and Section 24, *as amended*, 15 U. S. C. § 77x, of the Securities Act of 1933.

(C) Section 3(a)(9), *as amended*, 15 U. S. C. § 78c(a)(9); Section 3(a)(12), *as amended*, 15

U. S. C. § 78c(a)(12); Section 3(d), 15 U. S. C. § 78c(d); Section 10(b), 15 U. S. C. § 78j(b); Section 15B(d)(1), 15 U. S. C. § 78o-4(d)(1); Sections 21(a) and (e), *as amended*, 15 U. S. C. §§ 78u(a) and (e); and Section 32(a), 15 U. S. C. § 78ff(a), of the Securities Exchange Act of 1934, and Rule 10b-5, 17 C. F. R. § 240.10b-5, promulgated thereunder.

(D) Rule 202.5, 17 C. F. R. § 202.5, and Rule 203.4, 17 C. F. R. § 203.4, promulgated under the Securities Act of 1933 and the Securities Exchange Act of 1934.

The above constitutional provisions, statutes and rules are printed in Appendix C, hereto, *infra*, pp. A17 to A30.

QUESTIONS PRESENTED

Whether the Three-Judge Court below erred in deciding the constitutionality of the preliminary investigation without considering the constitutionality of those provisions of the Securities Acts that purport to subject Appellants to the Commission's jurisdiction and that provide the procedural and substantive basis for the preliminary investigation.

Whether federalism and the Tenth Amendment to the Constitution of the United States prohibit Congress from exercising its power under the Commerce Clause to subject issuers of state and local governmental securities to the Commission's jurisdiction and to the investigatory, injunctive, anti-fraud and criminal provisions of the Securities Acts.

STATEMENT OF THE CASE

In May, 1976, the Commission initiated a preliminary investigation of possible Securities Acts violations by the City. This preliminary investigation, which constituted "enforcement activity" by the Commission, was purportedly conducted pursuant to the Commission's authority under the investigatory provisions of the 1933 and 1934 Acts. Sections 19(b) and 20(a) of the 1933 Act, 15 U. S. C. §§ 77s(b) and 77t(a), § 21(a) of the 1934 Act, 15 U. S. C. § 78u(a), and Rule 202.5, 17 C. F. R. § 202.5 (App. C, *infra*, pp. A20-21, A24 and A27-29). Appellants were allegedly subject to the Commission's jurisdiction by virtue of the use in the Acts' investigatory and anti-fraud provisions of the term "person", which is defined in § 2(2) of the 1933 Act, 15 U. S. C. § 77b(2), and § 3(a)(9) of the 1934 Act, 15 U. S. C. § 78c(a)(9), to include "a political subdivision".[2] The investigation was deemed preliminary under 17 C. F. R. § 202.5, rather than formal under 17 C. F. R. § 203.4, because the Commission's staff had not obtained a formal order of investigation.

Since the investigation was preliminary rather than formal, the Commission could not issue process to compel testimony or the production of documents. However, on several occasions in July, 1976, Appellants were requested to produce for the Commission vast quantities of materials relating to the issuance and sale of the City's General Obligation Bonds on July 22, 1975, and November 26, 1975, and to the City's financial condition in the period June 30, 1975, through January 1, 1976. Appellants were also informed that various persons, including Lennox L. Moak, the City's Director of Finance, would be requested

2. The 1975 Amendments to the 1934 Act changed, *inter alia*, the original definition of "person" which had not included "political subdivision." Pub. L. 94-29, § 3(2), 89 Stat. 97.

to testify under oath. The Commission made these sweeping demands despite the City's exemption as a municipal issuer from the regulatory and reporting provisions of the Acts.[3]

As a direct result of the preliminary investigation, the City suffered immediate harm. On July 13, 1976, the City disclosed the fact of the investigation in a Supplement to the Official Statement issued in connection with the City's Temporary Loan Notes, Series of July 13, 1976. On July 28, 1976, the First National Bank of Chicago notified the City by letter that it was withdrawing from the underwriting syndicate formed to purchase the Temporary Loan Notes. This action was a direct consequence of the investigation as disclosed in the Supplement. The City also became the subject of widespread adverse publicity to the effect that the investigation was concerned with whether Appellants had engaged in fraudulent activity.[4]

In addition to the immediate consequences of the investigation, the City also believed, and alleged in the Amended Complaint, that the Commission's action would cause it substantial future harm. Specifically, any Commission investigation would effectively impair Appellants' taxing and bond-issuing powers and their ability to finance essential governmental services.

On July 29, 1976, the City announced it would not accede to the Commission's requests for information. Simultaneously, Appellants filed this action, as a class

3. Section 3(a)(2) of the 1933 Act, 15 U.S.C. § 77c(a)(2), exempts municipal securities from the registration provisions of that Act. Similarly, §§ 3(a)(12), 3(d) and 15B(d)(1) of the 1934 Act, 15 U.S.C. §§ 78c(a)(12), 78c(d) and 78o-4(d)(1), exempt municipal issuers from the reporting, filing and disclosure provisions of that Act.

4. All the materials referred to in this paragraph were attached as exhibits to Plaintiffs' Memorandum In Opposition to Defendants' Motion to Dismiss.

action,[5] against the Commission and others, seeking injunctive relief and a declaratory judgment that the provisions of the 1933 and 1934 Acts, that purport to subject Appellants to the Commission's jurisdiction and to authorize either a preliminary or formal investigation of Appellants' conduct, violated, on their face and as applied, the Fifth and Tenth Amendments to the Constitution and were void. An Amended Complaint was filed on August 17, 1976.

The Commission responded to the Amended Complaint by filing a Motion to Dismiss pursuant to Rules 12(b)(1) and 12(b)(6) of the Federal Rules of Civil Procedure, contending that Appellants lacked standing, that the action was not ripe for adjudication and that the Appellants had failed to state a claim upon which relief could be granted. After oral argument on the Motion to Dismiss, the Three-Judge Court requested additional briefs on the constitutionality of the 1933 and 1934 Acts and subsequently heard oral argument on the constitutional issues.

In its Opinion, the Three-Judge Court concluded that Appellants had standing to maintain the action, but that only the issue of the constitutionality of the preliminary investigation was ripe for adjudication. The Court specifically found that the issues of the constitutionality of formal investigations and of the substantive provisions of the Acts were not ripe for review, even though these substantive provisions provided the sole jurisdictional, substantive and procedural bases for the preliminary investigation.

The constitutionality of the preliminary investigation was sustained because the Court concluded, on the basis of *National League of Cities v. Usery,* 426 U. S. 833

5. Although the parties submitted memoranda of law on the question of whether the action should proceed as a class action, the Court below took no action on the certification issue prior to dismissing the Amended Complaint.

(1976), that the preliminary investigation did not involve an order or command to Appellants to act in "areas of traditional governmental functions" (App. A, *infra,* p. A12) and thus did not constitute an "impermissible intrusion into state sovereignty" (App. A, *infra,* p. A13). The Court reached this conclusion without considering the effect of the Tenth Amendment and federalism on Congress' power to subject the Appellants to any of the provisions of the Acts.

THE FEDERAL QUESTION PRESENTED IS SUBSTANTIAL

This appeal raises a novel question regarding the right of state and local governments to issue and sell securities, free from federal scrutiny or control, to raise funds essential to the maintenance of their independent existence. Resolution of this question, which the Court below found to be substantial, will require a determination of the limits imposed on federal power in this area by the Tenth Amendment and the doctrine of federalism embodied in the Constitution. Before demonstrating the substantial nature of this question, the failure of the Three-Judge Court to address the constitutional issue actually presented by the Amended Complaint, and now before this Court on appeal, requires that the precise issue presented and the treatment accorded it below be briefly considered.

I. The Court Below Erred in Determining the Constitutionality of the Preliminary Investigation Without Considering the Constitutionality of the Substantive Provisions of the Securities Acts.

In the Amended Complaint, Appellants challenged the constitutionality of the substantive provisions of the Se-

curities Acts that Congress had sought to make applicable to state and local governments. The pendency of a preliminary investigation, initiated pursuant to § 19(b) of the 1933 Act, 15 U. S. C. § 77s(b), § 21(a) of the 1934 Act, 15 U. S. C. § 78u(a), and Rule 202.5, 17 C. F. R. § 202.5, was cited to establish that Appellants had standing to bring the action and that the action presented a case or controversy that was ripe for adjudication. Although Appellants requested that the preliminary investigation be enjoined, they did not challenge the constitutionality of the preliminary investigation outside the context of their broader challenge to the substantive provisions of the Acts that purportedly subjected Appellants to the Commission's jurisdiction for certain purposes, including preliminary investigations. The Appellants' challenge was directed equally toward all the provisions of the Acts that purportedly applied to state and local governments. The Commission's preliminary investigation was stressed merely as the specific event that had harmed the City and precipitated the filing of the action.

In its decision on the Commission's Motion to Dismiss, the Court below held that Appellants' action to the extent it involved formal investigations and the substantive provisions of the Acts was not ripe for adjudication.[6] The Court did conclude that the question of the constitutionality of the preliminary investigation was ripe for review, but proceeded to decide this question on a basis which totally ignored the issue actually raised by Appellants. Instead of determining whether Congress possessed the constitutional power to extend the coverage of the Securities Acts to Appellants, the Court merely examined

6. This aspect of the decision below is not before this Court, except to the extent that proper consideration of the constitutionality of the preliminary investigation requires consideration of the constitutionality of the statutory provisions which underlie it.

the preliminary investigation mechanism itself, without reference to the constitutionality of the underlying statutory base. The Court concluded the procedure itself was not inconsistent with the standard enunciated by this Court in *National League of Cities, supra,* because the preliminary investigation did not have the effect of ordering Appellants "to act in 'areas of traditional governmental functions'", and did not substitute "federal for state choices in a manner which significantly limits the States' 'freedom to structure integral operations' in such areas . . ." (App. A, *infra,* p. A12).

Generally, challenges to administrative procedures, such as preliminary investigations, fall within one or more of three broad categories:

> (1) Challenges that seek to invalidate the procedure on the basis of the constitutional invalidity of the statute pursuant to which it is conducted. *See, e.g., A. L. A. Schechter Poultry Corp. v. United States,* 295 U. S. 495 (1935); *Panama Refining Co. v. Ryan,* 293 U. S. 388 (1935); *Larche v. Hannah,* 177 F. Supp. 816 (W. D. La. 1959), *reversed,* 363 U. S. 420 (1960).
>
> (2) Challenges based on a contention that a regulation promulgated under a constitutional statute exceeds the statutory mandate. *See, e.g., Ernst & Ernst v. Hochfelder,* 425 U. S. 185 (1976).
>
> (3) Challenges directed to the validity of the procedure itself, without reference to the constitutionality or adequacy of the underlying statutory base. *See, e.g., Matthews v. Eldridge,* 424 U. S. 319 (1976).

The Court below erred when it treated Appellants' action as one falling within the third category instead of the first category. Appellants never contended that the statutory provisions and the Rule authorizing the pre-

liminary investigation were unconstitutional in and of themselves. Rather, all the statutory provisions allegedly applicable to Appellants were said to be unconstitutional because Congress lacked the authority, in the first instance, to extend the Securities Acts to Appellants. Appellants contend that even in the limited context of the preliminary investigation, the Court below could not have decided the issue actually before it without considering the constitutionality of the Securities Acts and that this Court should consider this question in deciding this appeal.

II. This Appeal Presents a Fundamental Constitutional Question Which Should Be Heard and Determined by the Supreme Court of the United States.

There are three reasons why Appellants' challenge to Congress' power to subject state and local governments to the Securities Acts presents a substantial constitutional question which should be heard and determined by this Court:

A. The question presented is central to the system of federalism established by the Constitution and involves the proper relationship between the states and the federal government.

B. The state and local interest involved, *i.e.* the power to borrow money, is of vital importance to each of the thousands of state and local governments which will necessarily be affected by the ultimate resolution of this question.

C. The decision below is inconsistent with this Court's decision in *National League of Cities v. Usery*.

A. This Appeal Presents a Question Central to the Proper Constitutional Relationship Between the States and the Federal Government.

No constitutional principle is more fundamental to the organization of our form of government than the principle that the states and the national government are separate and, in their assigned spheres, independent. Indisputably, each government must be free to exercise the constitutional powers delegated to it to preserve and maintain itself as a separate and independent entity. This essential tenet of federalism was succinctly stated by this Court in *Lane County v. Oregon*, 74 U. S. 101, 104 (1869):

> The people of the United States constitute one nation, under one government, and this government, within the scope of the powers with which it is invested is supreme. On the other hand, the people of each State compose a State, having its own government, and endowed with all the functions essential to separate and independent existence.

The preservation of a dual system of government requires recognition of specific limitations on each government's exercise of its powers, so that neither level can subject the other to direct control or supervision, or interfere with the other's operations and instrumentalities within its assigned sphere of power. This Court has recognized such limitations in striking down both state and federal legislation. In *Johnson v. Maryland*, 254 U. S. 51, 55 (1920), Justice Holmes, in an opinion invalidating state regulation of federal post employees, stated:

> Here the question is whether the State can interrupt the acts of the general government itself. With regard to taxation, no matter how reasonable, or how

> universal and undiscriminating, the State's inability to interfere has been regarded as established since McCulloch v. Maryland, 4 Wheat. 316, 4 L. ed. 579.

Similarly, this Court refused to sustain a federal bankruptcy statute intended to provide relief for political subdivisions on the ground that the statute "might materially restrict [a local government's] control over its fiscal affairs." *Ashton v. Cameron County Water Improvement Dist.*, 298 U. S. 513, 530 (1936).

More recently, this Court has shown a growing reluctance to allow any federal interference with a state's powers where such interference threatened to disturb the sovereign status of the state. These decisions recognize that the need to maintain the constitutionally prescribed division of powers between the two levels of government imposes limitations on the national government's exercise of its powers. In *Younger v. Harris*, 401 U. S. 37, 44 (1971), the Court refused to enjoin a state criminal prosecution out of concern for the principle of "comity" which was defined as:

> [A] proper respect for state functions, a recognition of the fact that the entire country is made up of a Union of separate state governments, and a continuance of the belief that the National Government will fare best if the States and their institutions are left free to perform their separate functions in their separate ways. . . . What the concept [represents] is a system in which there is a sensitivity to the legitimate interests of both State and National Governments, and in which the National Government, anxious though it may be to vindicate and protect federal rights and federal interests, always endeavors to do so in ways that will not unduly interfere with the legitimate activities of the States.

See also, Rizzo v. Goode, 423 U. S. 362 (1976); *Huffman v. Pursue, Ltd.*, 420 U. S. 592 (1975); *O'Shea v. Littleton*, 414 U. S. 488, 501 (1974).

The principle of non-interference applied in the foregoing cases was affirmed by this Court in *National League of Cities v. Usery*, 426 U. S. 833 (1976), which considered Congress' power to extend federal wage and hour legislation to state employees. In holding the 1974 Amendments to the Fair Labor Standards Act unconstitutional because they "operate[d] to directly displace the state's freedom to structure integral operations in areas of traditional governmental functions" (*id.* at 852), this Court specifically recognized that the Tenth Amendment and the more general concept of federalism placed limitations on federal actions directed at the states in areas reserved to them by the Constitution. *National League of Cities* went beyond previous decisions in this area by articulating a standard for determining whether a particular federal action impermissibly interferes with state sovereignty.

This Court in *National League of Cities* adopted a two-step mode of analysis which has general application in any case involving a conflict between state and federal powers. The first step requires a determination of whether the state power impinged upon involves "functions essential to [the state's] separate and independent existence." *Id.* at 845. If so, the court must then determine whether the federal action displaces state choices so as to "substantially restructure traditional ways in which local governments have arranged their affairs." *Id.* at 849. Applying this mode of analysis to the facts before it, this Court concluded first that the states' power to make wage and hour decisions regarding their employees was an attribute of sovereignty, vital to the states' performance of a variety of essential functions which enabled them to

preserve and maintain their sovereign status. The Court then determined that the impact of the 1974 Amendments was such that they affected ways in which local affairs were conducted to an impermissible extent. Since the federal action displaced state decisions and caused the state to restructure its affairs, the Court concluded that the 1974 Amendments were unconstitutional.

National League of Cities confirms the principle of intergovernmental immunity and establishes a standard against which any federal intrusion into the operations and instrumentalities of a state must be tested. This appeal raises the very same type of question concerning the appropriate relationship between the states and the federal government in an area which historically has been immune from federal regulation. For the first time in forty years, the federal government has exercised its purported jurisdiction over a local governmental unit and the issuance of its securities. Whether such control is constitutionally permissible can only be determined through the appropriate application of the *National League of Cities* standard. Because the protection of the states within our federal system is imperative, this Court should hear this appeal.

B. This Appeal Presents a Question of Vital Importance to the Independent Existence of State and Local Governments.

The power to manage and control its own financial and budgetary affairs is crucial to the existence of every state and local government and is of greater importance than the power to make wage determinations at issue in *National League of Cities.* Because of its importance, this power has always been deemed an attribute of state sovereignty. *Allied Stores of Ohio, Inc. v. Bowers,* 358 U. S. 522, 526 (1959).

The states' financial powers have historically been free from federal interference. Hamilton, in the *The Federalist,* No. 81, in referring to the article on taxation, wrote "[s]tate governments would [not] by the adoption of that plan be divested of the privilege of paying their own debts in their own way, free from every constraint but that which flows from the obligations of good faith." Quoted in *Edelman v. Jordan,* 415 U. S. 651, 661 n. 9 (1974). This Court has also consistently recognized "the imperative need of a State to administer its own fiscal operations." *Tully v. Griffin, Inc.,* 429 U. S. 68, 73 (1976); *Ashton v. Cameron County Water Improvement Dist.,* 298 U. S. 513 (1936).

In exercise of their power to raise money, the states and their political subdivisions regularly borrow through the issuance of debt instruments. The sale of these securities, no less than the taxing power, provides the states and local governments with the funds necessary if they are to provide their citizens with required services and preserve their independent identities. This Court has recognized the importance of such debt instruments to local government and accorded them tax-exempt status in *Pollock v. Farmers' Loan & Trust Co.,* 157 U. S. 429 (1895). In deciding that a federal tax on income derived from municipal bonds was unconstitutional, the Court noted (157 U. S. 601):

> These bonds and securities are as important to the performance of the duties of the state as like bonds and securities of the United States are important to the performance of their duties, and are as exempt from taxation of the United States as the former are exempt from the taxation of the states.

See also, Drew v. United States, 394 F. Supp. 340 (S. D. Texas 1975).

Justice Black and Justice Douglas, dissenting in *New York v. United States*, 326 U. S. 572 (1946), which upheld a federal tax on sales of mineral waters by New York State, recognized that the issuance of municipal securities involved an exercise of a state's sovereign powers (326 U. S. 591):

> *Here a State is disposing of some of its natural resources. Tomorrow it may issue securities,* sell power from its public power project, or manufacture fertilizer. *Each is an exercise of its power of sovereignty.* Must it pay the federal government for the privilege of exercising that inherent power? [Emphasis added].

Congress itself recognized that the issuance and sale of municipal securities is an "essential governmental function." Section 3(a)(2) of the 1933 Act, which exempts municipal securities from registration, originally provided that exempt securities included:

> Any security issued and guaranteed . . . by any political subdivision of a state or territory, or by any public instrumentality of one or more states or territories exercising an essential governmental function.

When the 1933 Act was amended on June 6, 1934, the words "exercising an essential governmental function" were deleted. The stated reason for the change was to *broaden* the scope of the exemption and "to extend the scope of the public instrumentality exemption to [the] expanding activities in which governments are engaging." I Loss, *Securities Regulations*, 562 and 562 n. 10 (1961).

Today municipal securities are still exempt from the registration provisions of the 1933 Act. Section 3(a)(2), 15 U. S. C. § 77c(a)(2). Similarly, despite the 1975

Amendments to the 1934 Act, such securities continue to be exempt from the filing, registration, reporting and disclosure provisions of that Act. Section 3(a)(12), *as amended*, 15 U. S. C. § 78c(a)(12); § 3(d), 15 U. S. C. §78c(d); § 15B(d)(1), 15 U. S. C. § 78o-4(d)(1).

These historical precedents establish that the power of the states to issue and sell securities satisfies the first requirement of the *National League of Cities* standard, because that power is indisputably a "function essential to [the states'] separate and independent existence." 426 U. S. 845.

Not only is the state power involved in this case an "essential function", but it also has been, and will be, adversely affected by Congress' attempt to subject Appellants to the Commission's jurisdiction and to the anti-fraud and criminal provisions of the Acts. If this expansion of federal power is sustained, the adverse effects on the states will be more pervasive than those under the 1974 Amendments which were invalidated in *National League of Cities*. First, the federal action in that case was directed toward a discrete area, the payment of wages to state and municipal employees. In this case, the federal action is directed toward the wide range of diverse activities the state engages in to issue and sell securities. Second, administrative compliance with the 1974 Amendments in *National League of Cities* only required the performance of acts which were basically ministerial. Compliance with the 1933 and 1934 Acts in this case will, in contrast, affect every aspect of the City's revenue-raising and financial affairs and will interfere with its freedom to make discretionary decisions that involve fundamental policy choices.

Appellants have alleged the numerous, specific harms which will flow from investigations for possible Securities Acts violations (Amended Complaint ¶¶ 48-62). The

Court below accepted these allegations as true for purposes of the Motion to Dismiss. It stated that the investigation, authorized by the Acts, had "a significant effect on the financing and distribution of municipal services" and that such an impact could effect the City's "freedom to structure integral operation in areas of traditional governmental functions" (App. A, *infra.* p. A12). Therefore, at this stage of the litigation, the second requirement of the *National League of Cities* has been satisfied, in that the interference with the traditional governmental function carries with it the potential to force a complete restructuring of the ways in which the City exercises its revenue-raising powers and, hence, provides services to its citizens.

Since the extension of the Securities Acts to state and local governments will affect and harm such governments, in apparent contravention of the limitations placed on federal interference in *National League of Cities,* this Court should hear this appeal to determine whether Congress has again impermissibly interfered with matters more appropriately left to local control. Such a determination is necessary due to the threat the Acts pose to state sovereignty.

C. The Decision Below Is Inconsistent With This Court's Decision in National League of Cities.

Despite the prior decisions of this Court barring federal interference with state functions and the specific standards established by *National League of Cities,* the Court below held that the Commission's preliminary investigation of possible Securities Acts violations by Appellants was constitutional. It read *National League of Cities* as invalidating only "such legislation under the Commerce Clause as *orders* the states to act in 'areas of

traditional governmental functions'" (App. A, *infra,* p. A12). Accordingly, it upheld the investigation because "the threshold requirement that the federal action *command* the City is lacking: the City has not been ordered to adopt any measure as to the financing and distribution of its services" (App. A, *infra* p. A12).

There is nothing in Justice Rehnquist's opinion that suggests that the prohibition against federal interference with essential state functions was conditioned on the federal government directing the states to perform some act. Rather, the Court determined the permissibility of the federal action according to its end result, by evaluating its likely ultimate effect and impact on the states. In making this determination, it examined a number of factors: (1) the increased costs imposed by the 1974 Amendments, *id.* at 846; (2) the reduction in services mandated by the rise in costs, *id.* at 846; (3) the additional forced relinquishment of governmental activities, *id.* at 847; and (4) the displacement of state policies on how they will structure delivery of governmental services, *id.* at 847-848. After the examination of these specific factors, the Court concluded (426 U. S. 851):

> Our examination *of the effect of the 1974* amendments, as sought to be extended to the States and their political subdivisions, satisfies us that both the minimum wage and maximum hour provisions *will impermissibly interfere* with the integral governmental functions of these bodies.
> [Emphasis added.]

Although Justice Rehnquist conceded that "particularized assessments of actual impact" were not crucial to the Court's decision, he re-emphasized the effect the application of the 1974 Amendments would have (426 U. S. 851):

> For even if we accept [contrary] assessments concerning the impact of the amendments, their application will nonetheless significantly alter or displace the States' abilities to structure employer-employee relationships. . . .

The effect-oriented approach and analysis employed in *National League of Cities* is consistent with the overriding concern of the Tenth Amendment and federalism: the maintenance and preservation of the states as separate and independent sovereign entities. Any federal action directed at the states *qua* states must be tested not by the *form* such action takes, but rather by what it does. The limits of permissible action should be measured by the harmful effects the federal system was designed to prevent. Throughout the opinion, Justice Rehnquist expressed concern for the role of the states in our federal system and their ability to function effectively, unimpaired by federal interference. *Id.* at 843 (quoting *United States v. Darby*, 312 U. S. 100, 124 (1941)); *Id.* at 844, 851, 852. Thus, the 1974 Amendments were analyzed according to whether they affected the states' ability to manage their own affairs in an independent fashion.

Given the method of analysis and the language employed, the *National League of Cities* opinion does not support the contention that federal action which interferes with vital state functions can be barred only if it is premised on a "command" or "order". The fact that the federal action challenged in *National League of Cities* involved legislation which affirmatively prescribed minimum wages and maximum hours does not mean that federal action is limited only when it involves on a "command" or "order". If this Court's decision in *National League of Cities* is to be so limited, then any federal intervention into state and local affairs is to be tolerated so long as it stops

short of a command, irrespective of how significant the impact or how excessive the exercise of federal power. If federalism and the Tenth Amendment are to have any substantive meaning, federal intervention into state affairs that has the effect of displacing state policy choices involving functions "essential" to the states' independent existence cannot be countenanced regardless of whether that intervention proceeds by fiat or by request. Therefore, *National League of Cities* should be read as establishing a general standard to be applied separately in each case on the basis of the particular facts before the court. Consequently, this Court should hear this appeal and clarify the test that should be applied in any case challenging federal action which affects the states.

Finally, even if the Court below were correct and *National League of Cities* does require an "order" or "command" directed to the City, that test is plainly satisfied if, as the Commission asserts, the City is subject to the investigatory,[7] anti-fraud[8] and criminal sections[9] of the Acts which provide the substantive basis for any investigation. It is apparent that this regulatory scheme, through the imposition of various sanctions, including civil and criminal penalties, will, if applicable to the City, *require* it to conform its activities in the financial markets to the various guidelines (many appropriate only to private issuers) promulgated by the Commission. In any consideration of the substantive provisions of the Acts, therefore, there can be no question that "the threshold requirement that the fed-

7. Sections 19(b) and 20(a) of the 1933 Act, 15 U. S. C. §§ 77s(b) and 77t(a), and § 21(a) of the 1934 Act, 15 U. S. C. § 78u(a).

8. Sections 12(2) and 17 of the 1933 Act, 15 U. S. C. § 771(2) and 15 U. S. C. § 77q, § 10(b) of the 1934 Act, 15 U. S. C. § 78j(b) and Rule 10b-5, 17 C. F. R. § 240.10b-5, promulgated thereunder.

9. Section 24 of the 1933 Act, *as amended*, 15 U. S. C. § 77x and § 32(a) of th 1934 Act, 15 U. S. C. § 78ff(a).

eral action *command* the City" is met (App. A., *infra*, p. A12). In fact, the Court below recognized this in concluding relative to Appellants' Fifth Amendment challenge: "the securities laws and regulations sufficiently specify the *obligations imposed on the City*" (App. A., *infra*, p. A14). [Emphasis added].

Thus, even if a command or order is required, this Court should still hear the appeal to clarify what constitutes a sufficient command or order.

CONCLUSION.

It is respectfully urged that for the reasons given above the questions presented herein are substantial. This Court should note probable jurisdiction of this appeal.

Respectfully submitted,

SHELDON L. ALBERT,
City Solicitor,
City of Philadelphia,
15th Fl., Municipal Services Bldg.,
Philadelphia, Pa. 19107
Counsel for Appellants.

EDWIN P. ROME,
WILLIAM E. TAYLOR, III,
JEANNE P. WROBLESKI,
BLANK, ROME, KLAUS & COMISKY,
1100 Four Penn Center Plaza,
Philadelphia, Pa. 19103
Special Counsel for Appellants.

ROBERT W. SAYRE,
JOSEPH B. STURGIS,
JOHN C. S. KEPNER,
THOMAS J. SHARBAUGH,
SAUL, EWING, REMICK & SAUL,
38th Fl., Centre Square West
Philadelphia, Pa. 19102
Special Counsel for Appellants.

APPENDIX A.

UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

Civil Action No. 76-2396

CITY OF PHILADELPHIA and LENNOX L. MOAK, as Director of Finance, Individually and as representatives of the class,

Plaintiffs,

v.

SECURITIES AND EXCHANGE COMMISSION, RODERICK M. HILLS, Chairman, PHILIP A. LOOMIS, JR., Commissioner, JOHN R. EVANS, Commissioner, IRVING M. POLLACK, Commissioner, PAUL F. LEONARD, Administrator of Region 9, THOMAS H. MONAHAN, Assistant Regional Administrator,

Defendants.

Before: SEITZ, *Chief Judge, U. S. Court of Appeals for the Third Circuit,* NEWCOMER and CAHN, *District Judges for the Eastern District of Pennsylvania.*

Sheldon L. Albert, City Solicitor for the City of Philadelphia, Edwin P. Rome, Esquire, Neal Steinman, Esquire and Jeanne P. Wrobleski, Esquire of Blank, Rome, Klaus & Comisky; Robert W. Sayre, Esquire, Joseph B. Sturgis, Esquire, John C. S. Kepner, Esquire of Saul, Ewing, Remick & Saul for plaintiffs.

Edward E. Ellers, Esquire, Philadelphia, Pennsylvania, and Harvey L. Pitt, General Counsel, Paul Gonson, Associate General Counsel, Kathryn B. McGrath, Assistant General Counsel, Glynn L. Mays, Esquire, Sammy S. Knight, Esquire, John P. Sweeney, Esquire and Sue E. Auerbach, Esquire of Securities and Exchange Commission, Washington, D. C. for defendants.

OPINION OF THE COURT.

SEITZ, *Chief Judge.*

This case arises out of an SEC "preliminary investigation" into the offer, sale, and resale of securities of the City of Philadelphia during the last half of 1975. The City and its Director of Finance, Lennox L. Moak, brought this action to halt the investigation on their own behalf, and purportedly on behalf of a class of Pennsylvania political subdivisions and officials.

Defendants, who are the SEC and officials thereof, have moved to dismiss the case on grounds that: a) this court lacks jurisdiction to entertain it, b) the complaint fails to state a claim on which relief can be granted. This is the decision on that motion.

I.

The SEC's Philadelphia Branch Office began the present investigation in May of 1976. The Office has only undertaken a "preliminary" investigation, which is to say that no investigatory "order" has been issued. *Compare* 17 CFR 202.5 *with* 17 CFR 203.4. Consequently, under

Commission rules the Office at this point may merely request the City's cooperation, and may not compel it to furnish evidence. In July of 1976, the Office did in fact request the City to furnish "[a]ny and all records, data, documentation, reports or other information in your possession or under your control with respect to or pertaining to the sale, resale and distribution" of certain City securities which had been sold during the latter half of 1975, "and with respect to the past, present or projected financial condition . . . of the City, during the period June 30, 1975 to January 1, 1976 . . ." The City was also informed that the Office would request City officials to testify under oath. The City, however, responded that it would not comply with the Office's requests. Pursuant to an agreement between the parties, the Office has now halted its investigation pending the progress of this action.

The Complaint alleges that the pendency of the "preliminary" investigation violates plaintiffs' rights under the Fifth and Tenth Amendments, and that the substantive provisions of the securities laws violate these rights as well. It also alleges that the Commission activities have caused and will cause injury to the City in that they undermine the confidence of investors and investment analysts, and thus, inter alia, will cause an increase in the interest rates the City must pay on its securities, which will make debt servicing and the provision of municipal services more difficult. Plaintiffs seek a declaratory judgment establishing that: 1) the defendants may not by formal or informal proceedings seek information from or conduct any investigation of any member of the purported class 2) the provisions of the 1933 and 1934 Acts are unconstitutional facially and as applied to named plaintiffs and the purported class. Plaintiffs also seek parallel temporary and permanent injunctive relief.

II.

Defendants have questioned the substantiality of the constitutional questions raised by the Complaint, and thus the jurisdiction of this three-judge court. But the Supreme Court's decision in *National League of Cities v. Usery*, 426 U. S. 833 (1976), establishes that the Constitution imposes some limitations on how federal action may affect the "conduct of integral governmental functions," and we think it clear that the nature of these limitations is a sufficiently substantial question to support our jurisdiction. *Hagans v. Lavine*, 415 U. S. 528, 536-8 (1974).

Although the parties have not discussed the point, we note that that § 25(a) of the 1934 Act, which makes a Commission "order" reviewable only in the courts of appeals, does not deprive this court of its power to take jurisdiction of the case under 28 U. S. C. § 2282 and to review the issues in accordance with the provisions of the Administrative Procedure Act. *PBW Stock Exchange, Inc. v. Securities and Exchange Commission*, 485 F. 2d 718 (3d Cir. 1973) at n. 3. *See Califano v. Mister Sanders*, 45 U. S. L. W. 4209 (U. S. February 23, 1977); *Independent Broker-Dealers' Trade Association v. Securities and Exchange Commission*, 442 F. 2d 132 (D. C. Cir. 1971).

III.

The defendants have raised several challenges to the justiciability of the case which require greater discussion.

They first contend that the case is non-justiciable because the plaintiffs lack standing. The doctrine of standing, to the extent it is based on Article III's "case or controversy" requirement,[1] requires plaintiffs to allege facts

1. The "prudential limitations" which underlie a second component of the law of standing do not indicate dismissal. This, for example, is not a case where the "asserted harm is a 'generalized grievance' shared in substantially equal measure by all or a large

"from which it reasonably could be inferred" that relief would "likely" remedy specific injuries to them, past or threatened, which "fairly can be traced" to the defendants. *Warth v. Seldin*, 422 U. S. 490, 504 (1975); *Simon v. Eastern Kentucky Welfare Rights Organization*, 426 U. S. 26, 38 (1976).

Defendants present three arguments to support their contention that plaintiffs lack standing.

First, they state that any deterioration in potential investors' confidence in the City was caused not by the investigation, but by the very factors which prompted the investigation. But while defendants deny that the investigation has had the alleged effect, the City disputes the point, and we "must construe the complaint in favor of the complaining party." *Warth v. Seldin*, 422 U. S. at 501 (1975). It "reasonably could be inferred" that an injury to the financial reputation of the City is fairly traceable to the pendency of the investigation.

Defendants next argue that the allegations of injury are mere speculations as to how "unspecified third parties" might react to the pendency of the investigation, and that such speculations are insufficient to confer standing under the Supreme Court's decisions in *Linda R. S. v. Richard D.*, 410 U. S. 614 (1973), *Warth v. Seldin, supra*, and *Simon v. Eastern Kentucky Welfare Rights Organization, supra*. As the Supreme Court stated in *Eastern Kentucky*, this trilogy stands for the principle "that indirectness of injury, while not necessarily fatal to standing . . . ." may undermine the inference that plaintiffs' injuries "fairly can be traced" to the defendants in any given case. 426 U. S. at 38. We agree with the defendants that the harm involved here stems from the alleged reactions of investors to the SEC

1. (Cont'd.)
class of citizens;" nor does plaintiffs' claim depend on "the legal rights or interests of third parties." *Warth v. Seldin*, 422 U. S. 490, 499 (1975).

investigation, and thus may be said to flow only indirectly from the activities of the Commission. But we consider this case distinguishable from the Supreme Court trilogy in that the indirectness of the alleged injury does not mean that it is not fairly traceable to the defendants. It is a reasonable inference that potential investors who become aware of an SEC investigation will regard securities as less attractive, and will demand a higher rate of interest. As the SEC's Advisory Committee on Enforcement Policies and Practices said in its July 1, 1972 *Report:*

> The fact that an investigation has been ordered by the Commission itself is frequently interpreted by the public as a predetermination by the Commission that the party named in the Order has violated the law. Almost 40 years of repeated disclaimers have not succeeded in erasing that impression. pt. IV, pp. 18-19.

While this statement by the Advisory Committee refers in terms to investigations made pursuant to a formal Commission order, we believe it has strong implications for the present case, where the Commission has never acted to dispel the natural inference that its "preliminary" investigation into the financial affairs of the City is focused, in part, on possible securities violations by the City.

Defendants' third argument concerning standing is that prospective relief against further inquiry would not help the City, and might well increase its problems, since investors would conclude that it had been freed of SEC supervision, and was so afraid of what the investigation might disclose that it went to this court to cloak its finances in secrecy. Defendants' argument improperly assumes that the investigation, if prolonged, would not act as a continued affront to the City's trustworthiness and

financial integrity. Admittedly, if we grant the relief plaintiffs have requested, many investors will remember that the investigation was judicially halted and did not clear the City. But we think it likely that the pendency of the investigation would tend to further erode investor confidence and also to vitiate any efforts the City might make to present a positive financial image. Moreover, it is simply not correct to say that the investing public as a whole is so suspicious of public officials and of the motives which underlie the making of legal arguments that they would interpret any decree we rendered in defendants' favor as merely one device in a scheme to coverup the City's financial embarrassments. We believe that many investors could appreciate that the City might want to stand on any legal rights it may have solely because doing so would aid the City's finances and would avoid setting bad precedents for the future.

Thus, we conclude that named plaintiffs do have standing. We express no view as to the propriety of class certification.

IV.

Defendants next argue that the case is moot, since the City has already declined to cooperate with the informal inquiry, and there is only a "bare possibility of further action by the Commission or its staff." However, in *United States v. W. T. Grant Co.,* 345 U. S. 629, 632-3 (1953), the Supreme Court said that "voluntary cessation of allegedly illegal conduct does not deprive the tribunal of power to hear and determine the case, i.e., does not make the case moot . . . [unless] 'there is no reasonable expectation that the wrong will be repeated.'" [citations omitted]. Defendants have failed to make the required showing. On the contrary, as the Commission admits in

one of its Memoranda under the agreement between the parties "all Commission investigative activity in this matter has *temporarily* been halted, pending further proceedings in this action." [emphasis added].

Our conclusion that the constitutionality of the "preliminary" investigation is not moot under Article III also implies that the likelihoood of recurrence is sufficient for Article III ripeness. Apart from Article III, however, plaintiffs also show that the agency action in question is sufficiently "final" for judicial review under the APA. 5 U. S. C. § 704. This question must be answered in the affirmative. Administrative remedies need not be exhausted when the constitutionality of the agency action is in question. *E.g., Public Utilities Commission v. United States,* 355 U. S. 534 (1958). *Oklahoma Press Publishing Co. v. Walling,* 327 U. S. 186 (1946) and *Securities and Exchange Commission v. Wall Street Transcript Corp.,* 422 F. 2d 1371 (2d Cir.), *certiorari denied,* 398 U. S. 958 (1970), which are relied upon by defendants, are not to the contrary. Indeed, in those cases the courts considered on the merits constitutional challenges to the enforcement of administrative subpoenas.

In sum, plaintiffs' challenge to the constitutionality of the "preliminary" investigation is ripe for our consideration. Separate ripeness questions, however, are posed by the challenges to the constitutionality of: a) a "formal investigative proceeding"—that is, one undertaken pursuant to a Commission order of investigation 17 CFR 203.4 (b) the substantive provisions of the securities laws.[2]

2. Under the 1975 amendments to the Exchange Act, the City as an issuer of securities is exempt from registration and reporting requirements prior to the sale of securities. 15 U. S. C. 780-4(d)(1)-(2) (Supp. V 1975). The amendments, however, do not expressly address the SEC's power *after* sale. Nor do the amendments exempt the City from the antifraud provisions of the securities laws.

In the first place, it is wholly speculative whether the SEC will ever order that a formal investigation be undertaken into the offer, sale, and resale of City securities. As to the constitutionality of the substantive provisions of the securities laws, the City has not alleged that it is considering acting in a way which may be contrary to the prohibitions of the securities laws or regulations. *Compare, e.g., Abbott Laboratories v. Gardner,* 387 U. S. 136 (1967). Moreover, the SEC has, at this point, made neither formal nor informal efforts to secure the City's compliance with the substantive provisions of the Acts, and it is wholly speculative whether it will do so in the future. *Compare Regional Rail Reorganization Act Cases,* 419 U. S. 102 (1974); *Lake Carriers Association v. MacMullan,* 406 U. S. 498 (1972). These issues are therefore not ripe.

We conclude that the complaint properly raises for review the constitutionality of the "preliminary" investigation into the offer, sale, and resale of City securities. We will not, however, decide the constitutionality of a "formal" investigation [3] or of the substantive provisions of the securities laws, as these issues are not ripe for review.

V.

Plaintiffs' challenge to the constitutionality of the SEC's "preliminary" investigation proceeds on two grounds. They first argue that limitations inherent in the Commerce Clause,[4] and the Tenth Amendment prohibit Congress from authorizing the investigation because it impermissibly

3. We of course recognize that the considerations relevant to the constitutionality of the "preliminary" investigation may well be similar to those which are pertinent to the constitutionality of a "formal" investigation.

4. The defendants argue that even if the "preliminary" investigation cannot be authorized under the Commerce Clause, it is valid under the postal power. In view of our disposition of the Commerce Clause question, we need not address this contention.

infringes upon the sovereignty of the Commonwealth of Pennsylvania, of which the City is a political subdivision. Second, plaintiffs argue that the statutes [5] and regulations authorizing the investigation violate due process because they are impermissibly vague.

1. In *National League of Cities v. Usery, supra,* the Supreme Court invalidated amendments to the Fair Labor Standards Act which extended the Act's minimum wage and maximum hour provisions to almost all employees of states and their political subdivisions. The Court held that "insofar as the challenged amendments operate to directly displace the States' freedom to structure integral operations in areas of traditional governmental functions, they are not within the authority granted Congress" under the Commerce Clause. 426 U. S. at 852. It rested, in part, on the Tenth Amendment, which it found to be "an express declaration of . . . limits upon the authority of Congress to regulate the activities of States as States . . ." 426 U. S. at 842.

In the present case, plaintiffs allege that the pendency of the "preliminary" investigation disrupts the City's financing in several ways, chiefly by forcing the City to offer a higher rate of return on its securities. Thus, it is argued, the investigation operates to "directly displace the [City's] freedom to structure integral operations" in the area of finance. *National League of Cities v. Usery,* 426 U. S. at 852. Plaintiffs argue that their claim under

5. 15 U. S. C. §§ 77s(b), 77t(a) authorize the SEC to investigate possible violations by any "person" of the 1933 Act; 15 U. S. C. § 77(b)(2) states that the term "person" includes any "government or political subdivision thereof." 15 U. S. C. § 78u(a) authorizes the SEC to investigate possible violations by any "person" of the 1934 Act, and to conduct investigations which will facilitate such functions as recommending legislation to Congress; 15 U. S. C. 78c(a)(9) defines "person" to include any "government, or political subdivision, agency, or instrumentality of a government."

National League of Cities entitles them to declaratory and injunctive relief preventing defendants from: a) "request-[ing] production of documents or testimony from Plaintiffs and the members of the class" and b) "conduct[ing] any form of investigation of Plaintiffs and the members of the class."

Plaintiffs' amended complaint, fairly read, alleges that the "preliminary" investigation is aimed at possible securities violations by the City, and we must assume the truth of this allegation for purposes of this motion to dismiss. Thus, we must determine whether a "preliminary" investigation aimed at least in part at possible securities violations by the City is, as plaintiffs assert, an impermissible intrusion into state sovereignty. If the SEC may properly make possible securities violations by the City a target of the "preliminary" investigation, it is true *a fortiori* that the Commission may "request production of documents or testimony" from the City. *See United States v. Nixon,* 418 U. S. 683 (1974).

The amendments to the Fair Labor Standards Act involved in *National League of Cities* directly commanded states and their political subdivisions to follow specified minimum wage and maximum hour provisions in their employment relations. The Supreme Court's concern that this command substituted federal choices for state choices so as to directly displace the states is evident at several points in its opinion. For example, the Court said that: "[i]f Congress may withdraw from the States the *authority* to make those fundamental employment decisions upon which their systems for performance of these functions must rest, we think there would be little left of the States' [sovereignty]." 426 U. S. at 851 (emphasis added). The Court also noted that "the dispositive factor is that Congress has attempted to exercise its Commerce Clause authority to *prescribe* minimum wages and maximum hours

to be paid by the States in their capacities as sovereign governments." 426 U. S. at 852 (emphasis added).

In sum, we read *National League of Cities* to invalidate such legislation under the Commerce Clause as *orders* the states to act in "areas of traditional governmental functions," and which, by virtue of this order, substitutes federal for state choices in a manner which significantly limits the "States' freedom to structure integral operations" in such areas. As noted above, the City does allege that the investigation has a significant effect on the financing and distribution of muncipal services, which are clearly "areas of traditional governmental functions," and for purposes of this motion to dismiss, we must accept the truth of this allegation. But the threshhold requirement that the federal action *command* the City is lacking: the City has not been ordered to adopt any measure as to the financing and distribution of its services. Since there has been no command imposed upon the City in this case, it also necessarily follows that the alleged effect upon the City's "freedom to structure integral operations in areas of traditional governmental functions" is not due to a federal command.

Plaintiffs argue that the investigation has such an effect upon the City's access to funds that it leaves City officials with little choice as to how to conduct the City's finances, and thus in actuality orders the City as to how to conduct its affairs. This argument proves too much, since it implies that every instance in which federal action has a significant *de facto* effect upon states or their political subdivisions involves an impermissible interference with state sovereignty. We find no basis either in *National League of Cities*, or in the Commerce Clause and Tenth Amendment, on which to conclude that the innumerable statutes which have a significant de facto effect upon the states are invalid. Such *de facto* effect is a necessary attribute of a federal system. Indeed, we note that

extending the states' immunity to include federal action other than that which is mandatory upon them[6] would invalidate such legislation as the Social Security Act, a measure based upon the spending power which "seeks to" and does "affect the integral operations of state government," but persuades, rather than coerces the states, by offering funds to those whose plans qualify under the federal scheme.[7] *National League of Cities v. Usery*, 426 U. S. at 852 n. 17; *see Steward Machine Co. v. Davis*, 301 U. S. 548 (1937).

In sum, the "preliminary" investigation does not constitute an impermissible intrusion into state sovereignty.

2. Plaintiffs' second attack on the constitutionality of the statute and regulations authorizing the "preliminary" investigation is that they are void for vagueness. Much of plaintiffs' argument on the vagueness point is relevant only to the constitutionality of the substantive provisions

6. The Supreme Court has made clear that the states' immunity does not even extend to all direct federal commands. In *Fitzpatrick v. Bitzer*, 427 U. S. 445 (1976), the Court upheld the constitutionality of amendments to Title VII of the Civil Rights Act of 1964 which extend the coverage of the Act to the states as employers; the Court noted that the amendments were enacted under § 5 of the Fourteenth Amendment, and were not Commerce Clause measures like those involved in *National League of Cities. Fitzpatrick v. Bitzer*, 427 U. S. at 453 n. 9; *see National League of Cities v. Usery*, 426 U. S. at 852 n. 17.

Moreover, it is possible that the Court will hold that some legislation under the Commerce Clause may permissibly order the states to act in "areas of traditional governmental functions." Justice Blackmun's concurring opinion states that: "I may misinterpret the Court's opinion, but it seems to me that it adopts a balancing approach, and does not outlaw federal power in areas such as environmental protection, where the federal interest is demonstrably greater and where state facility compliance with imposed federal standards would be essential." 426 U. S. at 856.

7. We need not discuss the proper treatment of federal action which has only a de facto effect on the states but is primarily motivated by the air of "affect[ing] the integral operations of state government."

of the securities laws, a question which, as we have noted, is not ripe for review. In fact, the only argument, possibly advanced, which is relevant to the constitutionality of the "preliminary" investigation is that the securities laws and regulations delegate undue discretion to the SEC in deciding what to investigate, since these laws and regulations, especially those pertaining to fraud, do not sufficiently specify what the City's obligations are. *See Gregory v. City of Chicago,* 394 U. S. 111 (1969.) We conclude that the securities laws and regulations sufficiently specify the obligations imposed upon the City; the reasons for this conclusion are sufficiently well set forth in other cases that they need not be repeated here. *See, e.g., Coplin v. United States,* 88 F. 2d 652, 657 (9th Cir.), *cert. denied,* 301 U. S. 703 (1937).

Plaintiffs' challenge to the constitutionality of the "preliminary" investigation will be dismissed for failure to state a claim upon which relief can be granted. To the extent the amended complaint challenges other provisions of the Act it will be dismissed for want of ripeness.

/s/ COLLINS J. SEITZ
Collins J. Seitz
Chief Judge, U. S. Court of Appeals for the Third Circuit

/s/ CLARENCE C. NEWCOMER
Clarence C. Newcomer
United States District Judge

/s/ EDWARD N. CAHN
Edward N. Cahn
United States District Judge

APPENDIX B.

May 20, 1977

UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

Civil Action No. 76-2396

CITY OF PHILADELPHIA and LENNOX L. MOAK, as Director of Finance, Individually and as representative of the class,
Plaintiffs,

v.

SECURITIES AND EXCHANGE COMMISSION, RODERICK M. HILLS, Chairman, PHILIP A. LOOMIS, JR., Commissioner, JOHN R. EVANS, Commissioner, IRVING M. POLLACK, Commissioner, PAUL F. LEONARD, Administrator of Region 9, THOMAS H. MONAHAN, Assistant Regional Administrator,
Defendants.

ORDER

ORDERED that plaintiffs' challenge to the constitutionality of the "preliminary" investigation is dismissed for failure to state a claim upon which relief can be granted.

To the extent the amended complaint challenges other provisions of the Act it is dismissed for want of ripeness.

/s/ COLLINS J. SEITZ
Collins J. Seitz
Chief Judge, U. S. Court of Appeals for the Third Circuit

/s/ CLARENCE C. NEWCOMER
Clarence C. Newcomer
United States District Judge

/s/ EDWARD N. CAHN
Edward N. Cahn
United State District Judge

DATED:

APPENDIX C.

The Constitution of the United States of America, Tenth Amendment.

The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people.

Section 2(2) of the Securities Act of 1933, 15 U. S. C. § 77b(2).

DEFINITIONS

When used in this subchapter, unless the context otherwise requires—

• • •

(2) The term "person" means an individual, a corporation, a partnership, an association, a joint-stock company, a trust, any unincorporated organization, or a government or political subdivision thereof. As used in this paragraph the term "trust" shall include only a trust where the interest or interests of the beneficiary or beneficiaries are evidenced by a security.

• • •

Section 3(a)(2) of the Securities Act of 1933, 15 U. S. C. § 77c(a)(2).

EXEMPTED SECURITIES

(a) Except as hereinafter expressly provided, the provisions of this subchapter shall not apply to any of the following classes of securities:

• • •

(2) Any security issued or guaranteed by the United States or any territory thereof, or by the District of Columbia, or by any State of the United States, or by any political subdivision of a State or territory, or by any public instrumentality of one or more States or territories, or by any person controlled or supervised by and acting as an instrumentality of the Government of the United States pursuant to authority granted by the Congress of the United States; . . . .

• • •

Section 12(2) of the Securities Act of 1933, 15 U. S. C. § 771(2).

CIVIL LIABILITIES ARISING IN CONNECTION WITH PROSPECTUSES AND COMMUNICATIONS

Any person who—

• • •

(2) offers or sells a security (whether or not exempted by the provisions of section 77c of this title, other than paragraph (2) of subsection (a) of said section), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission,

shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

• • •

Section 17 of the Securities Act of 1933, 15 U. S. C. § 77q.

FRAUDULENT INTERSTATE TRANSACTIONS

(a) It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails directly or indirectly—

(1) to employ any device, scheme, or artifice to defraud, or

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

(b) It shall be unlawful for any person, by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, to publish, give publicity to, or circulate any notice, circular, advertisement, newspaper, article, letter, invest-

ment service, or communication which, though not purporting to offer a security for sale, describes such security for a consideration received or to be received, directly or indirectly, from an issuer, underwriter, or dealer, without fully disclosing the receipt, whether past or prospective, of such consideration and the amount thereof.

(c) The exemptions provided in section 77c of this title shall not apply to the provisions of this section.

• • •

Section 19(b) of the Securities Act of 1933, 15 U. S. C. § 77s(b).

SPECIAL POWERS OF COMMISSION

(b) For the purpose of all investigations which, in the opinion of the Commission, are necessary and proper for the enforcement of this subchapter, any member of the Commission or any officer or officers designated by it are empowered to administer oaths and affirmations, subpoena witnesses, take evidence, and require the production of any books, papers, or other documents which the Commission deems relevant or material to the inquiry. Such attendance of witnesses and the production of such documentary evidence may be required from any place in the United States or any Territory at any designated place of hearing.

• • •

Sections 20(a) and (b) of the Securities Act of 1933, 15 U. S. C. § 77t(a) and (b).

INJUNCTIONS AND PROSECUTION OF OFFENSES

(a) Whenever it shall appear to the Commission, either upon complaint or otherwise, that the provisions of

this subchapter, or of any rule or regulation prescribed under authority thereof, have been or are about to be violated, it may, in its discretion, either require or permit such person to file with it a statement in writing, under oath, or otherwise, as to all the facts and circumstances concerning the subject matter which it believes to be in the public interest to investigate, and may investigate such facts.

(b) Whenever it shall appear to the Commission that any person is engaged or about to engage in any acts or practices which constitute or will constitute a violation of the provisions of this subchapter, or of any rule or regulation prescribed under authority thereof, it may in its discretion, bring an action in any district court of the United States or United States court of any Territory, to enjoin such acts or practices, and upon a proper showing a permanent or temporary injunction or restraining order shall be granted without bond. The Commission may transmit such evidence as may be available concerning such acts or practices to the Attorney General who may, in his discretion, institute the necessary criminal proceedings under this subchapter. Any such criminal proceeding may be brought either in the district wherein the transmittal of the prospectus or security complained of begins, or in the district wherein such prospectus or security is received.

• • •

Section 24 of the Securities Act of 1933, as Amended, 15 U. S. C. § 77x.

PENALTIES

Any person who willfully violates any of the provisions of this subchapter, or the rules and regulations promulgated by the Commission under authorithy thereof, or

any person who willfully, in a registration statement filed under this subchapter, makes any untrue statement of a material fact or omits to state any material fact required to be stated therein or necessary to make the statements therein not misleading, shall upon conviction be fined not more than $10,000 or imprisoned not more than five years, or both.

• • •

Section 3(a)(9) of the Securities Exchange Act of 1934, as Amended, 15 U. S. C. § 78c(a)(9).

DEFINITIONS AND APPLICATION.

(a) When used in this chapter, unless the context otherwise requires—

• • •

(9) The term "person" means a natural person, company, government, or political subdivision, agency, or instrumentality of a government.

• • •

Section 3(a)(12) of the Securities Exchange Act of 1934, as Amended, 15 U. S. C. § 78c(a)(12).

§ 78c. DEFINITIONS AND APPLICATION.

(a) When used in this chapter, unless the context otherwise requires—

• • •

(12) The term "exempted security" or "exempted securities" includes securities which are direct obligations of, or obligations guaranteed as to principal or interest by, the United States; such securities issued or guaranteed by corporations in which the United States has a direct or indirect interest as shall be designated for exemption by

the Secretary of the Treasury as necessary or appropriate in the public interest or for the protection of investors; municipal securities, as defined in paragraph (29) of this subsection: *Provided, however,* That municipal securities shall not be deemed to be "exempted securities" for purposes of sections 78*o*, 78*o*–3 (except subsections (b)(6), (b)(11), and (g)(2) thereof), and 78q–1 of this title; . . .

• • •

Section 3(d) of the Securities Exchange Act of 1934, 15 U. S. C. § 78c(d).

DEFINITIONS AND APPLICATION.

Issuers of Municipal Securities

(d) No issuer of municipal securities or officer or employee thereof acting in the course of his official duties as such shall be deemed to be a "broker", "dealer", or "municipal securities dealer" solely by reason of buying, selling, or effecting transactions in the issuer's securities.

• • •

Section 10(b) of the Securities Exchange Act of 1934, 15 U. S. C. § 78j(b).

MANIPULATIVE AND DECEPTIVE DEVICES.

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

• • •

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission

may prescribe as necessary or appropriate in the public interest or for the protection of investors.

• • •

Section 15B(d)(1) of the Securities Exchange Act of 1934, 15 U. S. C. § 78o-4(d)(1).

MUNICIPAL SECURITIES—REGISTRATION OF MUNICIPAL SECURITIES DEALERS.

• • •

Issuance of Municipal Securities

(d)(1) Neither the Commission nor the Board is authorized under this chapter, by rule or regulation, to require any issuer of municipal securities, directly or indirectly through a purchaser or prospective purchaser of securities from the issuer, to file with the Commission or the Board prior to the sale of such securities by the issuer any application, report, or document in connection with the issuance, sale, or distribution of such securities.

• • •

Sections 21(a) and (e) of the Securities Exchange Act of 1934, as Amended, 15 U. S. C. § 78u(a) and (e).

INVESTIGATIONS AND ACTIONS—AUTHORITY AND DISCRETION OF COMMISSION TO INVESTIGATE VIOLATIONS.

(a) The Commission may, in its discretion, make such investigations as it deems necessary to determine whether any person has violated, is violating, or is about to violate any provision of this chapter, the rules or regulations thereunder, the rules of a national securities exchange or registered securities association of which such person is a member or a person associated with a member, the rules of a registered clearing agency in which such

person is a participant, or the rules of the Municipal Securities Rulemaking Board, and may require or permit any person to file with it a statement in writing, under oath or otherwise as the Commission shall determine, as to all the facts and circumstances concerning the matter to be investigated. The Commission is authorized in its discretion, to publish information concerning any such violations, and to investigate any facts, conditions, practices, or matters which it may deem necessary or proper to aid in the enforcement of such provisions, in the prescribing of rules and regulations under this chapter, or in securing information to serve as a basis for recommending further legislation concerning the matters to which this chapter relates.

• • •

MANDAMUS.

(e) Upon application of the Commission the district courts of the United States, the United States District Court for the District of Columbia, and the United States courts of any territory or other place subject to the jurisdictionof the United States shall have jurisdiction to issue writs of mandamus, injunctions, and orders commanding (1) any person to comply with the provisions of this chapter, the rules, regulations, and orders thereunder, the rules of a national securities exchange or registered securities association of which such person is a member or person associated with a member, the rules of a registered clearing agency in which such person is a participant, the rules of the Municipal Securities Rulemaking Board, or any undertaking contained in a registration statement as provided in subsection (d) of section 78*o* of this title, (2) any national securities exchange or registered securities association to enforce compliance by its members and persons associated with its members with the provisions of this chapter, the rules, regulations, and orders thereunder, and

the rules of such exchange or association, or (3) any registered clearing agency to enforce compliance by its participants with the provisions of the rules of such clearing agency.

• • •

Section 32(a) of the Securities Exchange Act of 1934, 15 U. S. C. § 78ff(a).

PENALTIES.

(a) Any person who willfully violates any provision of this chapter, or any rule or regulation thereunder the violation of which is made unlawful or the observance of which is required under the terms of this chapter, or any person who willfully and knowingly makes, or causes to be made, any statement in any application, report, or document required to be filed under this chapter or any rule or regulation thereunder or any undertaking contained in a registration statement as provided in subsection (d) of section 78*o* of this title or by any self-regulatory organization in connection with an application for membership or participation therein or to become associated with a member thereof, which statement was false or misleading with respect to any material fact, shall upon conviction be fined not more than $10,000, or imprisoned not more than five years, or both, except that when such person is an exchange, a fine not exceeding $500,000 may be imposed; but no person shall be subject to imprisonment under this section for the violation of any rule or regulation if he proves that he had no knowledge of such rule or regulation.

• • •

Rule 10b-5, 17 C. F. R. 240.10b-5.

EMPLOYMENT OF MANIPULATIVE AND DECEPTIVE DEVICES.

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of

interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,
in connection with the purchase or sale of any security.

• • •

Rule 202.5, 17 C. F. R. § 202.5.

ENFORCEMENT ACTIVITIES.

(a) Where, from complaints received from members of the public, communications from Federal or State agencies, examination of filings made with the Commission, or otherwise, it appears that there may be violation of the acts administered by the Commission or the rules or regulations thereunder, a preliminary investigation is generally made. In such preliminary investigation no process is issued or testimony compelled. When it appears from information obtained either with or without a preliminary investigation that there is a likelihood that a violation has been or is about to be committed and that the issuance of process may be necessary, the matter is reported to the Commission, which may then order a formal investigation or examination if it is deemed necessary. Unless otherwise ordered by the Commission, the investigation or examination is nonpublic and the reports thereon are for staff and Commission use only.

(b) Where it appears after investigation or otherwise that there has been a violation of any of the provisions of the acts administered by the Commission or the rules or regulations thereunder, the Commission may take one or more of the following actions: institution of administrative proceedings looking to the imposition of remedial sanctions, initiation of injunction proceedings in the courts, and, in the case of a willful violation, reference of the matter to the Department of Justice for criminal prosecution. The Commission may also on some occasions refer the matter to other Federal agencies, State authorities or organizations such as the stock exchanges or the National Association of Securities Dealers, Inc.

(c) Persons who become involved in preliminary or formal investigations may, on their own initiative, submit a written statement to the Commission setting forth their interests and position in regard to the subject matter of the investigation. Upon request, the staff, in its discretion, may advise such persons of the general nature of the investigation, including the indicated violations as they pertain to them, and the amount of time that may be available for preparing and submitting a statement prior to the presentation of a staff recommendation to the Commission for the commencement of an administrative or injunction proceeding. Submissions by interested persons should be forwarded to the appropriate Division Director or Regional Administrator with a copy to the staff members conducting the investigation and should be clearly referenced to the specific investigation to which they relate. In the event a recommendation for the commencement of an enforcement proceeding is presented by the staff, any submissions by interested persons will be forwarded to the Commission in conjunction with the staff memorandum.

(d) In instances where the staff has concluded its investigation of a particular matter and has determined that it will not recommend the commencement of an enforcement proceeding against a person, the staff, in its discretion, may advise the party that its formal investigation has been terminated. Such advice if given must in no way be construed as indicating that the party has been exonerated or that no action may ultimately result from the staff's investigation of the particular matter.

(e) The Commission has adopted the policy that in any civil lawsuit brought by it or in any administrative proceeding of an accusatory nature pending before it, it is important to avoid creating, or permitting to be created, an impression that a decree is being entered or a sanction imposed, when the conduct alleged did not, in fact, occur. Accordingly, it hereby announces its policy not to permit a defendant or respondent to consent to a judgment or order that imposes a sanction while denying the allegations in the complaint or order for proceedings. In this regard, the Commission believes that a refusal to admit the allegations is equivalent to a denial, unless the defendant or respondent states that he neither admits nor denies the allegations.

• • •

Rule 203.4, 17 C. F. R. § 203.4.

APPLICABILITY OF §§ 203.4 THROUGH 203.8.

(a) Sections 203.4 through 203.8 shall be applicable to a witness who is sworn in a proceeding pursuant to a Commission order for investigation or examination, such proceeding being hereinafter referred to as a "formal investigative proceeding."

(b) Formal investigative proceedings may be held before the Commission, before one or more of its members, or before any officer designated by it for the purpose of taking testimony of witnesses and received other evidence. The term "officer conducting the investigation" shall mean any of the foregoing.

APPENDIX D.

IN THE
UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

CIVIL ACTION NO. 76-2396

CITY OF PHILADELPHIA, et al.,
Plaintiffs,

v.

SECURITIES AND EXCHANGE COMMISSION, et al.,
Defendants.

Notice of Appeal to the Supreme Court of the United States.

(Filed: 7/18/77)

Notice is hereby given that plaintiffs City of Philadelphia and Lennox L. Moak hereby appeal to the Supreme Court of the United States from the final Order of the three-judge district court entered in this action on May 20, 1977, dismissing the Amended Complaint.

This Appeal is taken pursuant to 28 U. S. C. § 1253.

SHELDON L. ALBERT

/s/ SHELDON L. ALBERT
City Solicitor
City of Philadelphia
15th Floor, Municipal
Services Bldg.
Philadelphia, Pa. 19107
(215) MU 6-5230-3-4

BLANK, ROME, KLAUS & COMISKY

/s/ EDWIN P. ROME
Edwin P. Rome
WILLIAM E. TAYLOR, III
JEANNE P. WROBLESKI
1100 Four Penn Center
Plaza
Philadelphia, Pa. 19103
(215) 569-3700

Special Counsel for Plaintiffs

SAUL, EWING, REMICK & SAUL

/s/ ROBERT W. SAYRE
Robert W. Sayre
JOSEPH B. STURGIS
JOHN C. S. KEPNER
THOMAS J. SHARBAUGH
38th Floor, Centre Square
West
Philadelphia, Pa. 19102
(215) 972-7777

Special Counsel for Plaintiffs

Supreme Court, U. S.
FILED
NOV 30 1977
MICHAEL RODAK, JR., CLERK

No. 77-410

In the Supreme Court of the United States

OCTOBER TERM, 1977

CITY OF PHILADELPHIA, ET AL., APPELLANTS

v.

SECURITIES AND EXCHANGE COMMISSION, ET AL.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA

MOTION TO DISMISS OR AFFIRM

WADE H. MCCREE, JR.,
Solicitor General,
Department of Justice,
Washington, D.C. 20530.

HARVEY L. PITT,
General Counsel,

PAUL GONSON,
Associate General Counsel,

JAMES H. SCHROPP,
Assistant General Counsel,

SAMMY S. KNIGHT,
JOHN P. SWEENEY,
Attorneys,
Securities and Exchange Commission,
Washington, D.C. 20549.

INDEX

Page

Opinion below 1

Jurisdiction 1

Questions presented 2

Statement 2

Argument 5

Conclusion 15

CITATIONS

Cases:

Allen v. *Grand Central Aircraft Co.*, 347 U.S. 535 10

Boire v. *Greyhound Corp.*, 376 U.S. 473 10

Buckley v. *Valeo*, 424 U.S. 1 9

Flast v. *Cohen*, 392 U.S. 83 8

Franklin v. *Jonco Aircraft Corp.*, 346 U.S. 868 10

Fry v. *United States*, 421 U.S. 542 12

Gonzalez v. *Automatic Employees Credit Union*, 419 U.S. 90 6

International Longshoremen's Union v. *Boyd*, 347 U.S. 222 9

Morales v. *Turman*, 430 U.S. 322 8

MTM, Inc. v. *Baxley*, 420 U.S. 799 6

National League of Cities v. *Usery*, 426 U.S. 833 ..... 5, 11, 12

Page

Cases—continued:

Osceola v. *Kuykendall*, No. 77-18, appeal dismissed for want of jurisdiction, October 31, 1977 6

Paul v. *Davis*, 424 U.S. 693 13

Regional Rail Reorganization Act Cases, 419 U.S. 102 9

Steffel v. *Thompson*, 415 U.S. 452 9

Toilet Goods Association v. *Gardner*, 387 U.S. 158 9

Zemel v. *Rusk*, 381 U.S. 1 8

Constitution, statutes and regulation:

United States Constitution:

Fifth Amendment 4, 5

Tenth Amendment 4

Securities Act of 1933, 48 Stat. 74, as amended, 15 U.S.C. 77a *et seq.*:

Section 2(2), 15 U.S.C. 77(b)(2) 2

Section 3(a)(2), 15 U.S.C. 77c(a)(2) 2

Section 17(a), 15 U.S.C. 77q(a) 3

Section 19(b), 15 U.S.C. 77s(b) 3

Section 20(a), 15 U.S.C. 77t(a) 3

Section 20(c), 15 U.S.C. 77t(c) 3

Section 24, 15 U.S.C. 77x 3

Page

Constitution, statutes and regulation—continued:

Securities Exchange Act of 1934, 48 Stat. 881, as amended by the Securities Acts Amendments of 1975, Pub. L. 94-29, 89 Stat. 97, 15 U.S.C. (and Supp. V) 78a *et seq.*:

Section 3(a)(9), 15 U.S.C. (Supp. V) 78c(a)(9) 2

Section 3(a)(12), 15 U.S.C. (Supp. V) 78c(a)(12) 2

Section 10(b), 15 U.S.C. 78j(b) 3

Section 15B(d)(1), 15 U.S.C. (Supp. V) 78*o*-4(d)(1) 2

Section 21(a), 15 U.S.C. (Supp. V) 78u(a) 3, 8

Section 21(d), 15 U.S.C. (Supp. V) 78u(d) 3

Section 21(e), 15 U.S.C. (Supp. V) 78u(e) 3

Section 32(a), 15 U.S.C. 78ff(a) 3

Pub. L. 94-381, 90 Stat. 1119 4

28 U.S.C. 1253 7

28 U.S.C. (1970 ed.) 2281 4

28 U.S.C. (1970 ed.) 2282 ..... 4, 7

17 C.F.R. 202.5 3

Miscellaneous:

Comment, *Federal Regulation of Municipal Securities: A Constitutional and Statutory Analysis*, 1976 Duke L.J. 1261 9-10

Page

Miscellaneous—continued:

Doty & Petersen, *The Federal Securities Laws and Transactions in Municipal Securities*, 71 Nw. U. L. Rev. 283 (1976) 9

Note, *The Constitutionality of the Federal Regulation of Municipal Securities Issuers: Applying the Test of National League of Cities v. Usery*, 51 N.Y. U. L. Rev. 982 (1976) 10

Note, *Disclosure by Issuers of Municipal Securities: An Analysis of Recent Proposals and a Suggested Approach*, 29 Vand. L. Rev. 1017 (1976) 10

Note, *Federal Regulation of Municipal Securities*, 60 Minn. L. Rev. 576 (1976) 10

Note, *Federal Regulation of Municipal Securities: Disclosure Requirements and Dual Sovereignty*, 86 Yale L.J. 919 (1977) 9

Note, *Municipal Bonds and the Federal Securities Laws: The Results of Forty Years of Indirect Regulation*, 28 Vand. L. Rev. 561 (1975) 10

Securities and Exchange Commission Staff Report on Transactions in Securities of the City of New York, Committee Print of the Subcommittee on Economic Stabilization of the House Committee on Banking, Finance and Urban Affairs, 95th Cong., 1st Sess. (1977) 14

Page

Miscellaneous—continued:

Tribe, *Intergovernmental Immunities in Litigation, Taxation and Regulation: Separation of Powers Issues in Controversies About Federalism*, 89 Harv. L. Rev. 682 (1976) 10

In the Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-410

CITY OF PHILADELPHIA, ET AL., APPELLANTS

v.

SECURITIES AND EXCHANGE COMMISSION, ET AL.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA

MOTION TO DISMISS OR AFFIRM

OPINION BELOW

The opinion of the district court (J.S. App. A1-A14) is reported at 434 F. Supp. 281.

JURISDICTION

The judgment of the district court (J.S. App. A15-A16) was entered on May 20, 1977. The notice of appeal (J.S. App. A31-A32) was filed on July 18, 1977.[1] The appeal was docketed on September 15, 1977. The jurisdiction of this Court is invoked under 28 U.S.C. 1253. For the reasons discussed at pages 5-8, *infra,* we submit that the Court should dismiss the appeal for want of jurisdiction.

---

[1]Appellants also have filed a notice of appeal to the court of appeals, which has stayed proceedings pending the outcome of this appeal (J.S. 3 n. 1).

QUESTIONS PRESENTED

1. Whether this Court has jurisdiction of the appeal in this case.

2. Whether the district court properly held that appellants' challenges to the constitutionality of certain provisions of the federal securities laws were not ripe for decision.

3. Whether an informal inquiry by the staff of the Securities and Exchange Commission into the offer and sale of securities of the City of Philadelphia is an unconstitutional intrusion on state sovereignty.

STATEMENT

States and political subdivisions are exempt from most of the provisions of the federal securities acts. They need not, for example, register their offerings of securities or file with the Securities and Exchange Commission copies of any prospectus they may choose to publish.[2] Political bodies, like everyone else, may not, however, distribute their securities by fraudulent means, and they are exposed to civil and criminal penalties if they should commit fraud

---

[2]See Section 15B(d)(1) of the Securities Exchange Act of 1934, as added by the Securities Acts Amendments of 1975, Pub. L. 94-29, 89 Stat. 137, 15 U.S.C. (Supp. V) 78*o*-4(d)(1). States and their subdivisions are included in the class of "persons" subject to the statutes only for limited purposes, and the limitations preclude application of the registration and certain disclosure requirements. See Section 2(2) of the Securities Act of 1933, 48 Stat. 74, 15 U.S.C. 77b(2) (defining governments as "persons"); Section 3(a)(2) of the same statute, as amended, 15 U.S.C. 77c(a)(2) (exempting governmental securities from most provisions of the statute); Section 3(a)(9) of the Securities Exchange Act of 1934, as amended, 89 Stat. 97, 15 U.S.C. (Supp. V) 78c(a)(9) (governmental bodies are "persons"); Section 3(a)(12) of the same statute, as amended, 89 Stat. 97, 15 U.S.C. (Supp. V) 78c(a)(12) (securities issued by governments are exempt from most substantive provisions of the statute).

in the sale of their securities.[3] Moreover, the Commission may require political bodies to furnish information in order to determine whether they are complying with the applicable substantive provisions of the statutes, or whether third parties are complying with the laws, or to determine whether changes should be proposed in the Commission's statutes or rules.[4]

Although the Commission thus possesses the authority to conduct investigations using compulsory process, it has established by regulation a preliminary procedure that is designed to determine whether a compulsory investigation should be conducted. 17 C.F.R. 202.5. A preliminary inquiry relies on the voluntary cooperation of persons in whose conduct the Commission is interested. It cannot involve resort to any of the Commission's statutory powers of compulsion, and, if the subjects of the inquiry decline to cooperate, the Commission may either close the investigation or authorize a formal investigation during which it would be able to make use of compulsory process.

---

[3]See note 2, *supra*. The anti-fraud provisions applicable to governments are Section 17(a) of the Securities Act of 1933, 48 Stat. 84, as amended, 15 U.S.C. 77q(a), and Section 10(b) of the Securities Exchange Act of 1934, 48 Stat. 891, 15 U.S.C. 78j(b). The civil injunctive provisions applicable to governments are Section 20(c) of the Securities Act of 1933, 48 Stat. 899, as amended, 15 U.S.C. 77t(c), and Sections 21(d) and (e) of the Securities Exchange Act of 1934, as amended, 89 Stat. 154-155, 15 U.S.C. (Supp. V) 78u(d) and (e). The criminal provisions applicable to governments are Section 24 of the Securities Act of 1933, 48 Stat. 87, 15 U.S.C. 77x, and Section 32(a) of the Securities Exchange Act of 1934, 48 Stat. 904, as amended, 15 U.S.C. 78ff(a).

[4]Investigations assisted by compulsory process are authorized by Sections 19(b) and 20(a) of the Securities Act of 1933, 48 Stat. 85-86, 15 U.S.C. 77s(b) and 77t(a), and by Section 21(a) of the Securities Exchange Act of 1934, as amended, 89 Stat. 154, 15 U.S.C. (Supp. V) 78u(a).

In May 1976 the Philadelphia Branch Office of the Commission began a preliminary inquiry into the offer, sale, and resale of securities of the City of Philadelphia. The Branch Office requested the City voluntarily to supply certain documents that might bear on the inquiry. The City declined and, on July 29, 1976, brought this suit seeking an injunction against the informal staff inquiry and any formal proceedings the Commission itself might desire to commence.[5] A three-judge district court was convened.[6] Appellants contended that the pendency of the preliminary inquiry adversely affected the market for the City's securities and violated the City's rights under the Fifth and Tenth Amendments to the Constitution (J.S. App. A2-A3).

The district court dismissed the action. It concluded that appellants' challenge to the substantive requirements of the federal securities statutes and to a formal investigation (making use of compulsory process) was premature (J.S. App. A9). The court pointed out that "it is wholly speculative whether the SEC will ever order that a formal investigation be undertaken into the offer, sale, and resale of City securities. As to the constitutionality of the substantive provisions of the securities laws, the City has not alleged that it is considering acting in a way which may be contrary to the prohibitions of the securities laws

[5]The City and its Director of Finance purported to represent a class of all political subdivisions of the Commonwealth of Pennsylvania. The Commission objected to maintaining this suit as a class action, and the district court did not rule on the propriety of the class allegation (J.S. App. A7).

[6]Because the suit was commenced before August 12, 1976, the provisions of Pub. L. 94-381, 90 Stat. 1119, which repealed 28 U.S.C. (1970 ed.) 2281 and 2282, do not apply, and the question whether a three-judge court was necessary therefore was determined under the former statute.

or regulations. * * * Moreover, the SEC has, at this point, made neither formal nor informal efforts to secure the City's compliance with the substantive provisions of the Acts, and it is wholly speculative whether it will do so in the future. * * * These issues are therefore not ripe" (*ibid.*).

The court also held (J.S. App. A9-A13) that appellants' challenge to the constitutionality of the preliminary inquiry was insubstantial. Although it recognized that, under *National League of Cities* v. *Usery*, 426 U.S. 833, Congress may not order States to take specific actions in certain areas of traditional governmental functions, it concluded that there can be no constitutional problem unless the federal government attempts to direct the particulars of state decisions. Here, the court held, the "threshold requirement that the federal action *command* the City is lacking: the City has not been ordered to adopt any measure as to the financing and distribution of its services" (J.S. App. A12, emphasis in original). The court finally rejected appellants' argument, based on the Fifth Amendment, that the statutes and regulations authorizing the preliminary inquiry were unconstitutionally vague (*id.* at A13-A14).[7]

ARGUMENT

1. The appeal should be dismissed for want of jurisdiction. Although appellants' complaint sought an injunction against the substantive provisions of the securities laws to the extent they applied to municipalities, and against the compulsory investigative powers of the Securities and Exchange Commission, the district court did not reach the merits of these contentions. It decided,

[7]Appellants appear to have abandoned the vagueness argument.

instead, that they are not ripe for decision. Although the court did hold that the Commission's preliminary inquiry was not unconstitutional, this decision does not implicate any of the statutes that appellants attack. Their appeal therefore should be pursued in the court of appeals.

a. Because the district court did not address the issues requiring consideration by a three-judge court, direct appeal does not lie to this Court. *MTM, Inc.* v. *Baxley,* 420 U.S. 799; *Gonzalez* v. *Automatic Employees Credit Union,* 419 U.S. 90. *MTM* held that this Court has no jurisdiction of a direct appeal from an order of a three-judge district court dismissing a case on federalism grounds, stating (420 U.S. at 804):

> [W]e conclude that a direct appeal will lie to this Court under § 1253 from the order of a three-judge federal court denying interlocutory or permanent injunctive relief only where such order rests upon resolution of the merits of the constitutional claim presented below.

Similarly, *Gonzalez* held that a dismissal for lack of standing should be appealed to the court of appeals rather than to this Court.

The same principle applies here. The dismissal of the action as unripe for resolution did not "rest[] upon resolution of the merits of the constitutional claim[s] presented" by appellants. In another case in which a three-judge district court dismissed a suit as unripe, this Court held that any appeal must be taken to the court of appeals. *Osceola* v. *Kuykendall,* No. 77-18, appeal dismissed for want of jurisdiction, October 31, 1977. *Osceola* controls this case.

b. The court of appeals did not dismiss the entire suit as unripe; it reached the merits of the challenge to the preliminary inquiry. But an appeal does not lie from this portion of the court's decision because 28 U.S.C. 1253, which authorizes direct appeals, permits such appeals only from judgments for which a three-judge court was required. Former 28 U.S.C. 2282 required a three-judge district court only when an "interlocutory or permanent injunction [is sought] restraining the enforcement, operation or execution of any Act of Congress for repugnance to the Constitution of the United States * * *." Appellants' challenge to the preliminary inquiry, however, does not implicate the constitutionality of any statute. The Commission's preliminary inquiry did not amount to action under a statute; it was, instead, part of the process of considering whether to take action authorized by statute.

The statutes appellants attack authorize an investigation with compulsory process, but no such investigation was under way here; they authorize sanctions to be imposed for violations of the anti-fraud requirements, but there has been no finding of violation and no proposal to impose sanctions. Every challenge to every identified statute was dismissed by the court of appeals as unripe, and, for the reasons already discussed, that decision is not reviewable on direct appeal. What was left—the resolution of the challenge to the preliminary inquiry—did not call any statute into question, and therefore did not

require a three-judge district court.[8] The appeal from the district court's decision therefore should be taken to the court of appeals.[9]

2. If the Court concludes that it has jurisdiction, then it should affirm the judgment of the district court.

a. The district court held that the challenge to the substantive provisions of the securities laws, and to the Commission's investigative powers, is unripe because none of those provisions has been applied to appellants, because appellants do not contend that they desire to violate any of the provisions, and because there is no imminent prospect of their enforcement against appellants (J.S. App. A9). This decision is correct.

---

[8]The challenge to the preliminary inquiry might be thought to call into question the statutes defining governmental bodies as "persons" subject to investigation, but it would not necessarily do so. The Commission's power of *preliminary* inquiry is not limited by statute to "persons." Moreover, the Commission may investigate and make reports looking toward legislation rather than enforcement. See Section 21(a) of the Securities Exchange Act of 1934, as amended, 89 Stat. 154, 15 U.S.C. (Supp. V) 78u(a). See also page 14, *infra*. Investigations of this sort do not depend on the definition of "person" or the constitutionality of any substantive provision of the securities laws, although the constitutional questions may have something in common (see J.S. App. A9 n. 3).

[9]*Flast* v. *Cohen*, 392 U.S. 83, 89-91, and *Zemel* v. *Rusk*, 381 U.S. 1, hold that a three-judge court is necessary to consider challenges to the administration of statutes alleged to be unconstitutional. A three-judge court therefore would have been necessary to pass on a request for an injunction against the Commission's use of its compulsory investigative powers. But in both *Flast* and *Zemel* the plaintiffs attacked an identified statute. No identified statute pertains to the Commission's preliminary inquiry, however, and a challenge to the Commission's practices is not, by itself, enough to require the convening of a three-judge court. See *Morales* v. *Turman*, 430 U.S. 322.

There was no reason for the district court to pass on the constitutionality of the statutory scheme in advance of its application to any member of the purported class. "Determination of the scope and constitutionality of legislation in advance of its immediate adverse effect in the context of a concrete case involves too remote and abstract an inquiry for the proper exercise of the judicial function." *International Longshoremen's Union* v. *Boyd*, 347 U.S. 222, 224, citations omitted; see also *Toilet Goods Association* v. *Gardner*, 387 U.S. 158, 166.

"[R]ipeness is peculiarly a question of timing" (*Regional Rail Reorganization Act Cases*, 419 U.S. 102, 140). See also *Buckley* v. *Valeo*, 424 U.S. 1, 113-118. A case is not ripe in the absence of some threat to enforce the statutes in question (*Steffel* v. *Thompson*, 415 U.S. 452, 459), and that threat could come about only if the plaintiff were to allege that it contemplated violating the statute. But appellants do not state that they plan to engage in securities fraud, and so, under their own argument, there would be no basis for enforcement of the statutes against them. Appellants will have a full opportunity to litigate the questions they now raise when, if ever, the Commission seeks to apply the securities laws to them.[10]

---

[10]Because the district court dismissed the action as unripe for decision, there would be no occasion for this Court to consider the constitutional arguments appellants present against the application of the substantive provisions of the securities laws to appellants. No court has yet passed on the questions involved, although they have evoked substantial scholarly commentary. See, *e.g.*, Note, *Federal Regulation of Municipal Securities: Disclosure Requirements and Dual Sovereignty*, 86 Yale L.J. 919 (1977); Doty & Petersen, *The Federal Securities Laws and Transactions in Municipal Securities*, 71 Nw. U. L. Rev. 283 (1976); Comment, *Federal Regulation of*

b. We now assume *arguendo* both that appellants are entitled to challenge the preliminary inquiry without exhausting their administrative remedies[11] and that any substantive regulation of the terms of securities offerings by the City would be unconstitutional.[12] Even on these

---

Municipal Securities: A Constitutional and Statutory Analysis, 1976 Duke L.J. 1261; Note, *Federal Regulation of Municipal Securities*, 60 Minn. L. Rev. 576 (1976); Note, *Disclosure by Issuers of Muncipal Securities: An Analysis of Recent Proposals and a Suggested Approach*, 29 Vand. L. Rev. 1017 (1976); Note, *Municipal Bonds and the Federal Securities Laws: The Results of Forty Years of Indirect Regulation*, 28 Vand. L. Rev. 561 (1975); Note, *The Constitutionality of the Federal Regulation of Municipal Securities Issuers: Applying the Test of National League of Cities* v. *Usery*, 51 N.Y. U. L. Rev. 982 (1976). Cf. Tribe, *Intergovernmental Immunities in Litigation, Taxation and Regulation: Separation of Powers Issues in Controversies About Federalism*, 89 Harv. L. Rev. 682 (1976).

[11]The district court held that "[a]dministrative remedies need not be exhausted when the constitutionality of the agency action is in question" (J.S. App. A8). Although this Court need not reach that question here, we believe that the district court is incorrect. In a similar case, in which subjects of regulation challenged a preliminary inquiry to determine whether a statute, alleged to be unconstitutional, had been violated, this Court summarily reversed a judgment of unconstitutionality, "the appellee having failed to exhaust its administrative remedy" (*Franklin* v. *Jonco Aircraft Corp.*, 346 U.S. 868). See also *Boire* v. *Greyhound Corp.*, 376 U.S. 473, 476-479; *Allen* v. *Grand Central Aircraft Co.*, 347 U.S. 535, 539-540. We do not pursue the matter here, however.

[12]We believe that nothing in the Constitution precludes application of the anti-fraud provisions of the securities laws to all issuers of securities, including governmental bodies. Congress has the power to regulate not only interstate commerce but also the use of the mails, and governmental bodies may no more use the mails to distribute fraudulent representations than they may use them to raise funds by distributing pornography. It is difficult to understand how making misleading statements or having material omissions in solicitations to purchase securities can be thought to be an essential attribute of state

assumptions, however, the district court correctly decided that nothing in the Commission's preliminary inquiry violated any provision of the Constitution.

The preliminary inquiry that the district court declined to enjoin involved only an informal request by staff members that the City provide certain information. The City was not required to comply and, indeed, did not do so. The injunction therefore could have had only two effects: first, to require the staff not to ask third parties for information about the City's securities, and, second, to require the staff to stop thinking about the City's securities or discussing them in private. The Constitution, however, does not place limits on what information an administrative agency may seek to acquire from willing sources or on internal discussions of agency staff.

National League of Cities v. *Usery*, 426 U.S. 833, on which appellants rely, held that Congress could not "wield its power in a fashion that would impair the States'

---

sovereignty or a function " 'essential to separate and independent existence' " of the States (*National League of Cities* v. *Usery*, 426 U.S. 833, 845).

Appellants have not contended that they desire to practice securities fraud or that municipal operations will be hindered in some way unless fraud or deceit is permitted. They therefore have not established the foundation for an argument based on *National League*: the "forced relinquishment of important governmental activities" (426 U.S. at 847). Although appellants argue that any regulation of the securities markets will interfere with their ability to raise money for governmental operations, it could as easily be argued that the application of the anti-fraud provisions of the securities acts will make investors more likely to believe statements by municipal securities issuers, and hence more likely to invest in municipal securities as opposed to already-regulated private securities. But however that may be, for the reasons stated in the text appellants' claim fails even if it is assumed that the Constitution places some restrictions on regulation of municipal securities.

'ability to function effectively in a federal system' " (426 U.S. at 852, quoting from *Fry* v. *United States*, 421 U.S. 542, 547 n. 7). The Court was concerned about direct commands issued by the federal government "to the States *qua* States" (426 U.S. at 847) and directly displacing the States' freedom to structure important governmental operations. The Court emphasized the nature of this concern by pointing out that it is activated when the federal government "seeks to regulate directly the activities of States" (*id.* at 841), bringing about the "forced relinquishment of important governmental activities" (*id.* at 847). The Court repeatedly emphasized that the flaw in the congressional plan was compulsion directed against the States.[13]

The Commission's preliminary inquiry involves no compulsion against the "States *qua* States" or anyone else. No state choice has been displaced directly. Perhaps, as appellants contend, private investors will be affected by their knowledge of the Commission's inquiry, but this effect, if it exists, is not unconstitutional.

We see no reason why Congress could not authorize the Commission to investigate state and municipal securities and then issue statements advising the investing public

[13]See, *e.g.*, 426 U.S. at 849 (the statute "directly penalizes the States" and the "congressionally imposed displacement of state decisions may substantially restructure traditional ways in which the local governments have arranged their affairs"); *id.* at 852 (the statute will "prescribe" wages and "directly displace the States' freedom to structure integral operations"); *id.* at 853 (a statute would be permissible if it "displaced no state choices as to how governmental operations should be structured" and did not "force" the States to change their ways); *id.* at 855 (Congress may not exercise its power "so as to force directly upon the States its choices as to how essential decisions regarding the conduct of integral governmental functions are to be made").

whether a particular offering was fairly described and a sound investment. See page 14, *infra*. In so doing, the Commission would be performing a role similar to that of a consumer adviser, and it would exercise no coercive powers. The Constitution would not prohibit the gratuitous distribution of consumer advice by the United States, even though some offerors of securities would be affected. Cf. *Paul* v. *Davis*, 424 U.S. 693. The distribution of advice would not coerce the States in any way, and it would affect them only because private choices might be influenced.

If the United States could issue advice to investors, it necessarily would have the authority to gather essential information from willing suppliers. But that is all the Commission has done or threatened to do here—it has attempted to gather information from willing suppliers. It has not even made or threatened to make any public statement about the results of its inquiry.

In sum, there has been no direct displacement of state choices. Appellants argue that there need be none, but that argument "proves too much, since it implies that every instance in which federal action has a significant *de facto* effect upon the states or their political subdivisions involves an impermissible interference with state sovereignty" (J.S. App. A12). Almost every action by the United States indirectly affects the States. For example, a decision by the United States Treasury to sell additional federal bonds or bills would attract investment funds that might otherwise be available to purchase municipal securities; no one, however, would seriously contend that the sale of federal securities is unconstitutional. Many other federal statutes affect the States: the provision of the Internal Revenue Code making income from municipal securities exempt from federal taxes enhances the attractiveness of those securities, yet the repeal of the

exemption would not be unconstitutional; moreover, as the district court pointed out (J.S. App. A13), appellants' argument would invalidate even those federal plans based on the federal spending power, including the Social Security Act, that are designed to influence state decisions by making particular courses of action especially attractive. These illustrations demonstrate that a federal action is not unconstitutional just because it has an indirect effect on municipal operations.

Finally, even a conclusion that any direct enforcement action against a municipality growing out of a preliminary investigation would be unconstitutional would not be a sufficient foundation for the relief appellants seek. The preliminary inquiry might serve as a forum to gather information that could serve as a basis for recommending legislation. For example, the Commission recently issued a staff report concerning transactions in securities by the City of New York; major portions of this study pertained only to the conduct of underwriters, rating agencies and bond counsel.[14] So long as any legitimate goal could be served by the inquiry, it could not properly be enjoined.

---

[14]Securities and Exchange Commission Staff Report on Transactions in Securities of the City of New York, Committee Print of the Subcommittee on Economic Stabilization of the House Committee on Banking, Finance and Urban Affairs, 95th Cong., 1st Sess. (1977).

CONCLUSION

The appeal should be dismissed for want of jurisdiction. If the Court concludes that it has jurisdiction of the appeal, it should affirm the judgment of the district court.

Respectfully submitted.

WADE H. MCCREE, JR.,
Solicitor General.

HARVEY L. PITT,
General Counsel,

PAUL GONSON,
Associate General Counsel,

JAMES H. SCHROPP,
Assistant General Counsel,

SAMMY S. KNIGHT,
JOHN P. SWEENEY,
Attorneys,
Securities and Exchange Commission.

NOVEMBER 1977.

DOJ-1977-11